Kenya Listed Commercial Banks Analysis

Cytonn Q1'2018 Banking Sector Report

"Diversification key to growth amid tighter regulation. Asset quality remains a concern"

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Table of Contents

Cytonn INVESTMENTS

I. Overview of the Firm

What We Stand For

Our Mission

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

Our Vision

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

Our Values

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

Excellence
Delivering the best at all times

Client Focus
Putting clients' interest first at all times

Entrepreneurship
Using innovation and creativity to deliver differentiated financial solutions

Accountability
We take both corporate and personal responsibility for our actions

Integrity
Doing the right things

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

— Jack Welch

About Us

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

82	Over Kshs. 82 billion worth of projects under mandate	**7**	Seven offices across 2 continents	**500**	Over 500 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

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 THREE MAIN CLIENTS SEGMENTS:

- 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

Education

We provide exceptional learning experiences for individual and societal transformation

Hospitality

We operate an aspirational brand, which by consistently delivering exceptional service, ensure utmost client satisfaction

Asset Management

We offer collective investment schemes, fund management and real estate investments to global and local investors with the aim of generating above market average risk adjusted returns

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

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
- 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
- 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
- Patricia N. Wanjama, CPS


AMARA RIDGE


SITU VILLAGE


THE ALMA
THE alma
RUAKA CAFE


NEWTOWN

II. Kenya Economic Review and Outlook

Kenya Economic Review

Of the 7 indicators we track, 4 are positive and 2 are neutral and 1 is negative. We maintain our positive outlook on the 2018 macroeconomic environment

Key Macro-Economic Indicators – Kenya					
Indicators	**Expectations at start of 2017/2018 Fiscal Year**	**YTD 2018 Experience**	**Going forward**	**Outlook- Beginning of Year**	**Current Outlook**
Government Borrowing	The government expected to borrow Kshs 317.7 bn from the domestic market for the 2017/18 financial year and Kshs 206.0 bn from the foreign market, while KRA had a revenue collection target of Kshs 1.7 tn for the 2017/18 fiscal year	i. The government is currently ahead of its domestic borrowing target for the 2017/18 fiscal year, having borrowed Kshs 377.6 bn against a pro-rated target of Kshs 280.4 bn ii. The government has borrowed 79.1% of its foreign borrowing target and 83.9% of their pro-rated target, for the fiscal year 2017/18, with the estimate having been revised up to Kshs 323.0 bn as per the 2018 BPS	With the interest rate cap still in place, we don't expect upward pressure on interest rates. Should the cap be repealed, we expect this to result in upward pressure on interest rates in the next borrowing cycle, as the government will no longer have an easy time collecting funds from the domestic market. However, with National Assembly against a complete repeal and The Draft Financial Markets Conduct Bill, 2018 having not addressed the issue of the interest rate cap, we still remain positive on government borrowing.	**Positive**	**Positive**
Currency	To remain stable supported by dollar reserves	The Shilling has appreciated by 2.3% against the USD YTD to 100.4 . The country's current account deficit expanded to 6.7% of GDP in 2017 from 5.2% in 2016 as per the KNBS report on account of faster growth of imports at 20.5%, as compared to export growth at 2.8% while Diaspora remittances increased by 56.6% to USD 217.1 mn in April 2018 from USD 138.6 mn in April 2017.	The government projects it to narrow to 5.4% of GDP in 2018 due to lower food and SGR imports. We expect the currency to remain relatively stable against the dollar, supported by, (i) stronger horticulture export inflows driven by increasing production (ii) improving diaspora remittances, and (iii) the ample reserves with the IMF having extended the standby credit facility of USD 1.5 bn (approx. 1 month import cover) by 6 months to September 2018, to allow for review	**Neutral**	**Neutral**

Kenya Economic Review, continued…

Of the 7 indicators we track, 4 are positive and 2 are neutral and 1 is negative. We maintain our positive outlook on the 2018 macroeconomic environment

Key Macro-Economic Indicators – Kenya					
Indicators	**Expectations at start of 2017/2018 Fiscal Year**	**YTD 2018 Experience**	**Going forward**	**Outlook- Beginning of Year**	**Current Outlook**
Interest Rates	A stable outlook on interest rates in 2017 with the CBR maintained at 10.0%	The MPC met on 28th May 2018 and maintained the CBR at 9.5% citing that the impact of the 50 bps reduction in March had not yet been fully transmitted to the economy, despite there being room for monetary policy easing to further support economic activity	The interest rate environment is expected to remain relatively stable with the CBK not accepting higher yields on treasury securities	**Neutral**	**Neutral**
Inflation	To average above the government annual target of between 2.5% - 7.5% in 2017	Inflation has averaged 4.2% in the first 5 months of 2018. The year on year inflation rate for the month of May rose to 4.0% from 3.7% in April , driven by a 1.4% and 1.8% rise in the food index and the housing, water, electricity, gas and other fuels' Index, respectively	Inflation in H2'2018 is expected to experience upward pressure, partly due to the base effect, and the expected rise in fuel and transport prices with the introduction of 16.0% VAT on petroleum products as from September 2018. However, we expect Inflation to average 7.0% in 2018 down from 8.0% in 2017 and within the government target	**Positive**	**Positive**
GDP Growth	GDP growth for 2017 to come in at between 4.7% - 5.2% , from 5.9% recorded in 2016	Kenya's economy grew by 4.9% in 2017, compared to 5.9% in 2016 in line with our expectation of between 4.7% - 5.2%. The consensus GDP growth projection for Kenya in 2018 is at 5.5% (an average taken from 14 research firms, global agencies and government organizations projections)	GDP growth is projected to come in between 5.4% - 5.6% in 2018 driven by recovery of growth in the agriculture sector, continued growth in the tourism, real estate and construction sectors, and growth in the manufacturing sector	**Positive**	**Positive**

Kenya Economic Review, continued…

Of the 7 indicators we track, 4 are positive and 2 are neutral and 1 is negative. we maintain our positive outlook on the 2018 macroeconomic environment

Key Macro-Economic Indicators – Kenya					
Indicators	**Expectations at start of 2017/2018 Fiscal Year**	**YTD 2018 Experience**	**Going forward**	**Outlook Beginning of Year**	**Current Outlook**
Investor Sentiments	Investor sentiment expected to improve in 2018 given the now settling operating environment after conclusion of the 2017 elections	The Kenya Eurobond was 7.0x oversubscribed partly showing the appetite for Kenyan securities by the foreign community, and investor confidence in Kenya's stable and relatively diversified Economy. The yields on Kenyan Eurobonds however, have been fluctuating reflecting mixed investor sentiments	Given (i) the now settling operating environment following conclusion of the elections, (ii) the expectation that long term investors will continue entering the market seeking to take advantage of the valuations which are still historically low, and (iii) expectations of a relatively stable shilling, we still expect investor sentiment to improve in 2018	**Positive**	**Positive**
Private Sector Credit Growth	Private sector credit growth expected to remain low, below the 5-year average of 14.0%	The latest data from CBK indicates that private sector credit growth came in at 2.8% in April 2018, higher than 2.1% in February 2018, but still remains below the 5-year average of 13.6%	Private sector credit growth is projected to remain low this year as the interest rate cap has made banks adopt a more stringent credit risk assessment framework thus limiting lending to riskier borrowers. Despite calls by the IMF to re-look at the Act, and the President's and National Treasury's endorsement of these sentiments, the National Assembly, who are the legislators, remain against the repeal of the law, claiming that banks colluded to frustrate the cap's efforts	**Negative**	**Negative**

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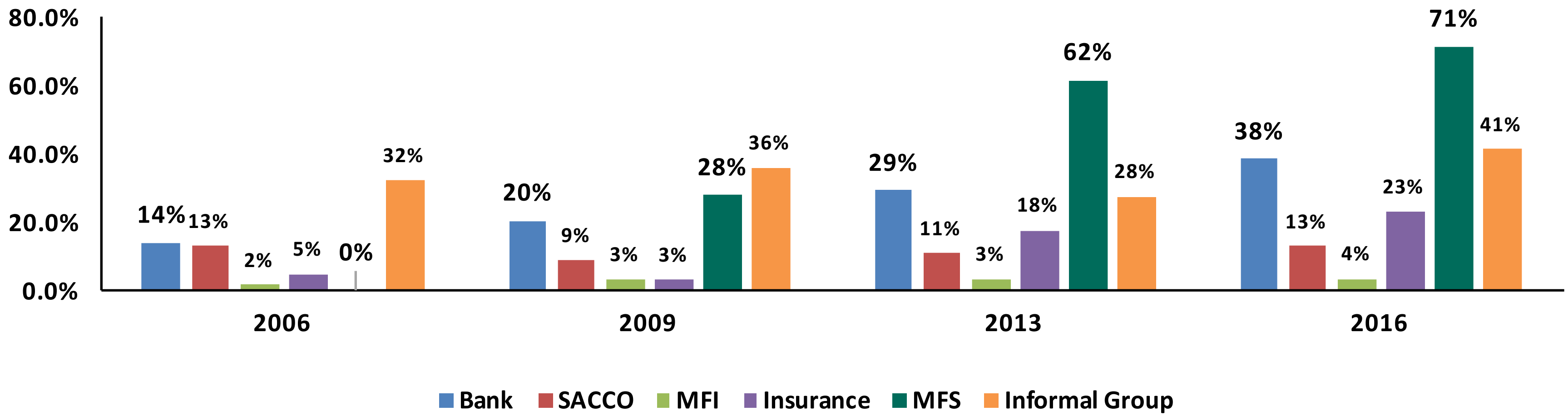
III. Kenya Banking Sector Overview

Kenya Banking Sector Overview

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

- In Kenya there are a total of 42 commercial banks, with Imperial and Chase Banks under receivership, 1 mortgage finance company, 13 microfinance banks, 9 representative offices of foreign banks, 74 foreign exchange bureaus, 19 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



Source: Central Bank of Kenya

Kenya Banking Sector Overview, continued…

The sector has witnessed several acquisitions over the past 5-years. In 2018, SBM Bank Kenya acquired certain assets and liabilities of Chase Bank Ltd, which was under receivership

- Kenya's banking environment is already going through consolidation as evidenced by heightened M&A activity over the last 4 years. During the quarter, SBM Bank Kenya Ltd completed the acquisition of certain assets and liabilities of Chase Bank Limited, which was under receivership. 75% of the value of all moratorium deposits at Chase Bank will be transferred to SBM Bank Kenya. The remaining 25% will remain with Chase bank Limited. However, the full transaction value is yet to be disclosed
- Below is a summary of key transactions done over the last five 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**	

- It is notable that acquisitions are also happening at much cheaper valuation compared to earlier bank acquisitions for example 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 Q1'2018 EPS increased by 14.4% y/y from an average decline of 8.6% witnessed in Q1'2017,, following the capping of interest rates

- Kenya's listed banks recorded a positive EPS growth of 14.4% in Q1'2018, compared to an 8.6% decline in Q1'2017. The increase was on the back of an 8.1% increase in Net Interest Income (NII) coupled with a 9.5% growth in Non-Funded Income (NFI) as banks adapted to operating under the interest rate cap regime. The Net Interest Margin (NIM) declined to 8.1% in Q1'2018 from 9.2% in Q1'2017
- Listed banks recorded net loans and advances growth of 3.2% y/y to Kshs 1.9 tn in Q1'2018 from Kshs 1.8 tn in Q1'2017. Deposits grew 9.4% y/y to Kshs 2.5 tn in Q1'2018 from Kshs 2.3 tn in Q1'2017

Banking Sector Growth Drivers

Alternative channels of transactions, operational efficiency and revenue diversification are the key growth drivers for banks

1) **Increased adoption of technology to improve efficiency:** Banks have been riding on the digital revolution wave to improve their operational efficiency. Increased adoption of alternative channels of transactions the number of transactions via alternative channels exceed those of bank branches, with the branches reduced to handling high value transactions. Thus banks reduced front-office operations, thereby reducing the staff required and by extension reducing operating expenses and hence improving operational efficiency
2) **Diversification to different revenue streams:** Banks have continued to diversify their revenue sources, as they adapt to operating under the interest rate cap regime. Banks increased the fees and commissions on loans and ventured into various NFI growth ventures such bancassurance. NFI was also earned from transactional income obtained as the number of transactions increased buoyed by increased adoption of alternative channels of transactions
3) **Growth of the middle class :** A rapidly expanding middle class with high expenditure habits, increased focus on convenience in accessing services, and an affinity of luxury goods has increased the demand for banking services
4) **Economic recovery:** The ongoing economic recovery will lead to improved demand for credit from sectors affected by the economic slump witnessed in 2017 due to political uncertainty and drought. Increased credit extended to sectors such as agriculture, real estate, manufacturing and trading presents interest income growth opportunities

Recent Developments in the Banking Sector

The Draft Financial Markets Conduct Bill is expected to address causal factors of low private sector credit growth and regulate financial conduct of industry participants

1. **Draft Financial Markets Conduct Bill 2018:** The National Treasury completed the Draft Financial Markets Conduct Bill, that seeks to address the whole credit management in the economy. The law, if approved, will see the establishment of the Financial Markets Conduct Authority that will:
   - Regulate the cost of credit with the aim of protecting consumers,
   - Promote a fair, non-discriminatory environment for credit access, and
   - Ensure uniformity in standards and practices in the issue of financial products and services

   The Bill has partly addressed its intended purpose i.e. consumer protection, but has not addressed the issue of the interest rate cap, and fails to address the problem of access to credit for the private sector, mainly by SMEs. In our view, it would be unwise to proceed with the Bill in its current form
2. **Venturing into bancassurance as a source of non-funded income:** We have seen further investment by banks in alternative sources of income, with I&M Holdings having completed a full buyout of Youjays Insurance Brokers for an undisclosed amount, Standard Chartered partnering with Sanlam and KCB partnering with Liberty Holdings for the education savings plan dubbed Elimisha. Banks continue to grow NFI by venturing mainly into bancassurance and increasing transactional income

Recent Developments in the Banking Sector, continued…

IFRS 9 standard comes into effect, causing banks to adopt more stringent lending policies, preferring to issue collateral backed credit

3. IFRS 9 Implementation: With the implementation of IFRS 9, which took effect from 1st January 2018, banks total capital position relative to their risky assets declined by an average of 0.3%. The implementation of IFRS 9 forced banks to review their business models, strategic objectives and credit policies. Thus banks adopted more stringent lending policies, and as a consequence lending was skewed towards collateral based lending as opposed to unsecured lending. To avoid the high provisioning levels that would be required, banks unwillingness to lend to the private sector and more specifically to SMEs is likely to persist

4.Loans to banks by international organizations for private sector and SME lending – Banks have been obtaining finance from international institutions mainly for onward lending to the private sector and SMEs, so as to plug a funding deficit occasioned by a mismatch in their assets and liabilities by tenor, as deposits tend to be relatively short term while loans are relatively long term. The funding issues so far have been summarized in the table below:

	Issuer	Bank	Amount of Loan (Kshs bn)	Term of Credit
1	IFC	Cooperative Bank	15.2	7-years
2	Africa Development Bank	Kenya Commercial Bank	10.4	Not specified
3	SwedFund	Victoria Commercial Bank	0.5	Not specified
4	14 financial Institutions (syndicated)	Stanbic Bank	10.0	2,3 years
	Total		**36.1**	

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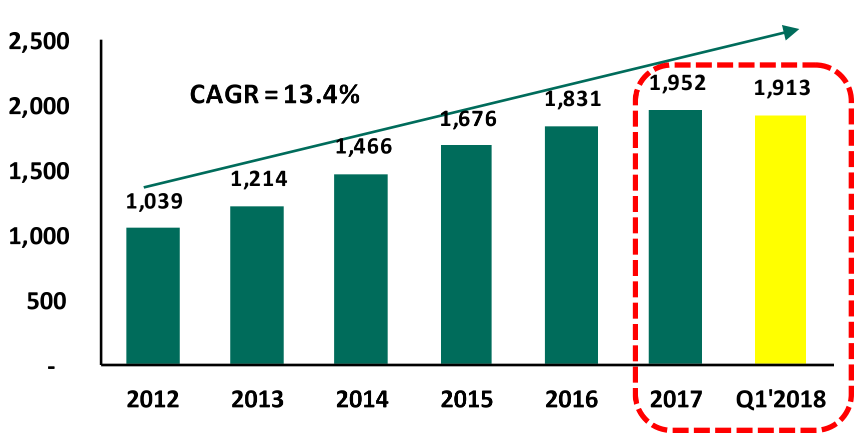
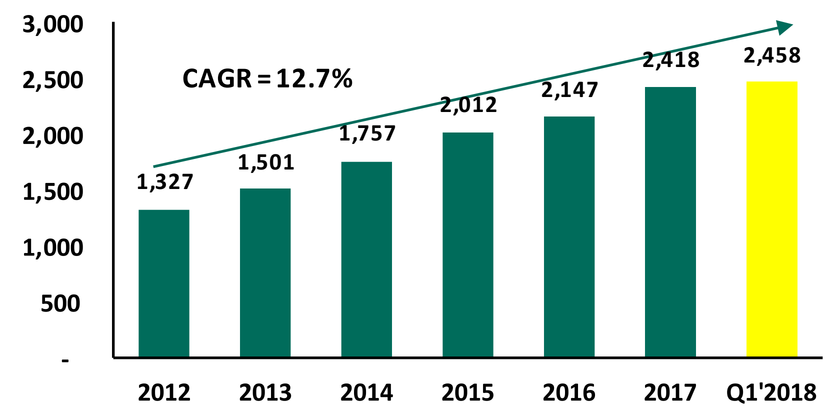
Listed Banking Sector Metrics

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

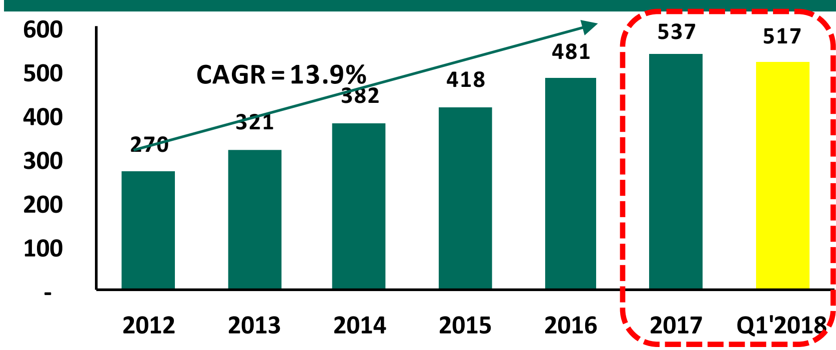
Loans and Advances (Kshs Bn)



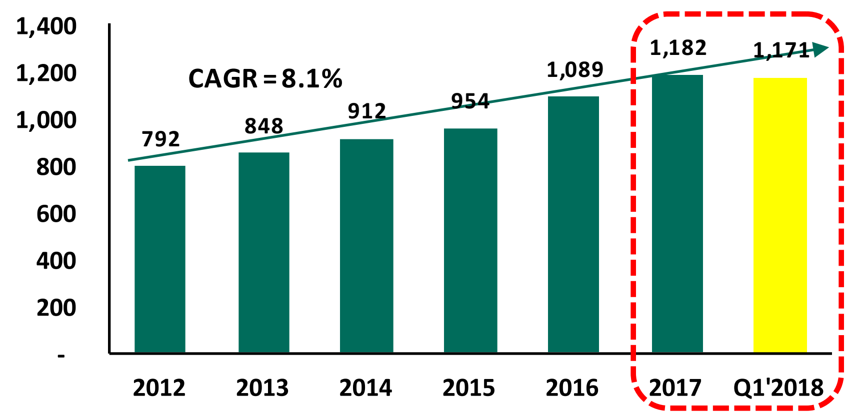
Deposits (Kshs Bn)



Shareholders Equity (Kshs Bn)



Bank Branches



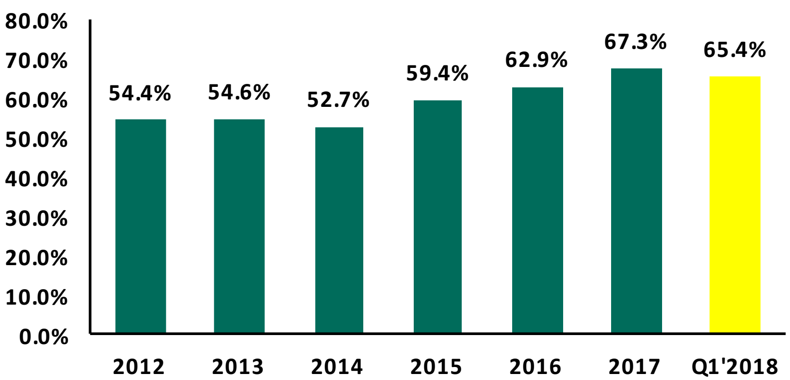
- The loans and advances, shareholders equity and bank branches slow down in Q1'2018 for the first time in the last 5 years

Source: Central Bank of Kenya

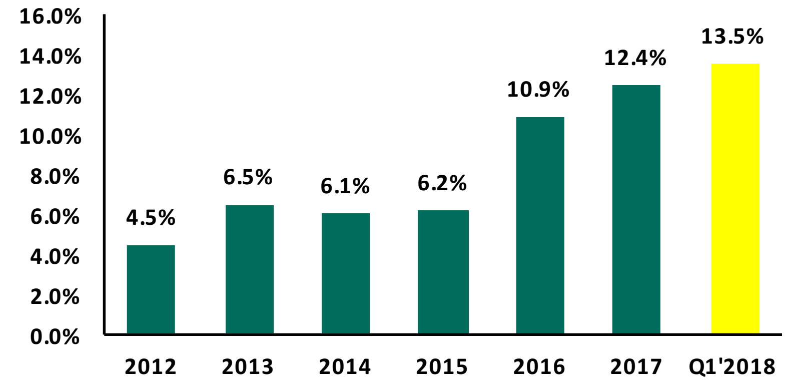
Listed Banking Sector Metrics, continued…

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

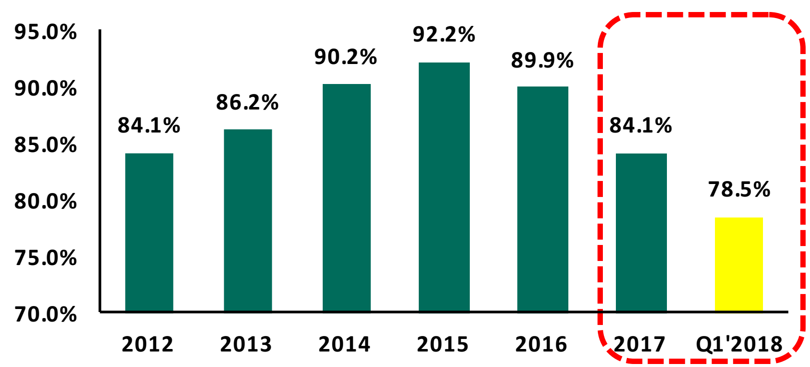
Cost to Income - with LLP (%)



NPLs to Total Loans (%)

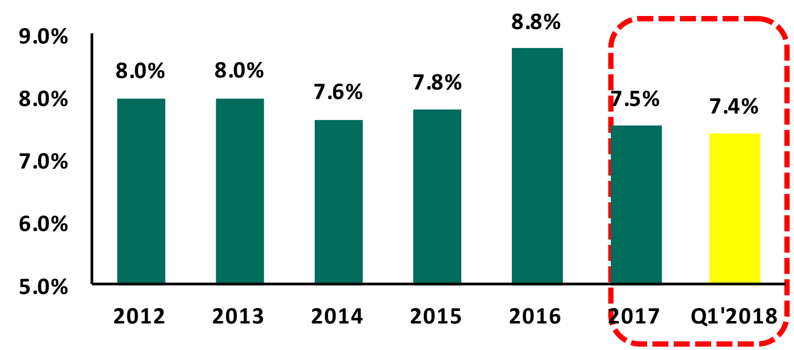


Loan to Deposits (%)



- The LDR has declined to 78.5% in Q1’2018 from 84.1% in FY’2017, with banks adopting a more prudent credit risk assessment framework to ensure quality loan books

Net Interest Margin (%)



- Bank’s NIMs have declined marginally to 7.4% from 7.5% in 2017, 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 FY'2017 Earnings & Growth Metrics

Kenya's banking sector Q1'2018 core EPS increased by 14.4% compared to a decline of 8.6% in Q1'2018

Bank	Core EPS Growth	Interest Income Growth	Interest Expense Growth	Cost of Funds	NII Growth	Net Interest Margin	NFI Growth	NFI to Total Operating Income	Growth in Total Fees and Commissions	Deposit Growth	Loan Growth	Growth in Govt. Securities	IFRS 9 Capital Ratios Effect
National Bank	348.0%	(14.2%)	(11.7%)	3.3%	(15.8%)	7.1%	(12.3%)	31.0%	91.3%	(6.3%)	(12.0%)	(9.8%)	(0.6%)
Stanbic	79.0%	17.7%	17.4%	3.3%	17.9%	7.0%	55.4%	49.0%	73.7%	13.2%	11.4%	83.5%	(0.6%)
Equity Group	21.7%	10.5%	10.5%	2.7%	10.5%	8.4%	6.3%	49.0%	7.2%	10.0%	3.5%	45.5%	(0.5%)
KCB Group	14.0%	10.9%	13.0%	3.1%	10.0%	8.2%	(1.1%)	32.8%	(2.3%)	8.7%	5.8%	(10.7%)	(0.8%)
Barclays	7.7%	8.1%	6.8%	2.9%	8.5%	9.6%	5.0%	29.2%	(6.7%)	8.4%	(1.9%)	35.3%	1.0%
Co-op Bank	6.8%	9.1%	5.0%	4.0%	10.8%	8.6%	3.8%	32.0%	9.6%	5.7%	2.8%	21.3%	(0.9%)
DTBK	3.0%	4.9%	4.2%	5.1%	5.4%	6.4%	4.4%	22.0%	8.3%	11.6%	3.0%	16.0%	(1.6%)
NIC Group	2.2%	8.2%	35.9%	5.2%	(8.3%)	6.3%	5.5%	29.6%	1.8%	22.1%	(0.4%)	81.2%	(0.8%)
I&M Holdings	1.8%	2.5%	10.9%	4.8%	(2.7%)	7.4%	43.9%	37.0%	45.9%	3.5%	7.6%	(1.7%)	(0.2%)
Stanchart	(12.5%)	7.7%	16.4%	3.6%	4.5%	7.8%	6.5%	32.0%	27.0%	13.2%	(2.6%)	12.4%	(0.5%)
HF Group	(58.4%)	(12.8%)	(13.0%)	7.2%	(12.6%)	5.1%	64.2%	28.9%	(62.7%)	(6.1%)	(12.5%)	(41.4%)	0.0%
Weighted Average Q1'2018	**14.4%**	**9.3%**	**11.4%**	**3.4%**	**8.1%**	**8.1%**	**9.5%**	**37.1%**	**12.2%**	**9.4%**	**3.2%**	**25.0%**	**(0.3%)**
Weighted Average Q1'2017	**(8.6%)**	**(11.6%)**	**(10.3%)**	**3.0%**	**(10.1%)**	**9.2%**	**18.6%**	**37.8%**	**8.7%**	**11.7%**	**7.1%**	**43.1%**	**0.0%**

Listed Banks Q1'2018 Operating Metrics

Kenya's banking sector Q1'2018 ROACE is at 18.4%

Listed Banks Q1'2018 Operating Metrics							
Bank	LDR	CIR	ROACE	Deposits Per Branch	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio
Co-operative Bank	85.4%	55.8%	17.6%	1.9	10.8%	30.6%	16.8%
KCB Group	84.3%	55.9%	20.3%	1.9	9.9%	58.6%	14.6%
Diamond Trust Bank	71.4%	56.3%	15.1%	2.0	7.1%	68.3%	13.2%
Equity Group	70.9%	49.6%	24.7%	1.4	6.5%	48.6%	14.4%
I&M Holdings	90.0%	52.8%	16.9%	4.1	13.8%	39.5%	17.0%
NIC Group	80.5%	60.7%	13.4%	2.9	12.9%	48.0%	15.1%
Barclays Bank	85.6%	64.8%	16.0%	2.2	7.2%	71.7%	14.9%
Standard Chartered	49.1%	61.0%	14.5%	6.4	14.0%	75.2%	15.1%
Stanbic Holdings	74.1%	71.7%	6.2%	5.7	7.8%	50.3%	12.9%
HF Group	113.1%	94.6%	0.7%	1.6	16.6%	39.2%	15.6%
National Bank	58.9%	95.7%	2.3%	1.2	42.9%	56.5%	5.1%
Weighted Average Q1'2018	**76.8%**	**56.6%**	**18.4%**	**2.8**	**9.5%**	**53.4%**	**14.9%**

** The weighted average is based on Market Cap as at 13th June, 2018*

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Listed Banking Sector Multiples

Kenya's banking sector is currently trading at an average PTBV of 1.6x and a PE of 9.1x

Bank	Share Price *	No. of Shares Issued (bns)	Market Cap (bns)	PBV	P/E	Dividend Yield
National Bank of Kenya	6.8	0.3	2.3	**0.2x**	**8.5x**	0.0%
Housing Finance Group	8.4	0.4	3.0	**0.3x**	**6.6x**	2.6%
NIC Bank	35.0	0.6	22.4	**0.7x**	**5.5x**	3.6%
Stanbic Holdings	94.5	0.4	37.4	**0.9x**	**8.9x**	4.4%
I&M Holdings	120.0	0.4	49.6	**1.2x**	**7.6x**	2.5%
Diamond Trust Bank Kenya	195.0	0.3	51.9	**1.2x**	**6.9x**	1.3%
KCB Group	48.8	3.1	151.4	**1.5x**	**7.7x**	6.2%
Standard Chartered Bank Kenya	200.0	0.3	68.7	**1.6x**	**9.5x**	5.1%
Barclays Bank of Kenya	11.9	5.4	64.6	**1.6x**	**9.4x**	8.4%
Co-operative Bank of Kenya	17.5	5.9	102.7	**1.6x**	**8.6x**	5.3%
Equity Group Holdings	49.3	3.8	185.9	**2.2x**	**11.7x**	3.6%
Weighted Average*			**739.8**	**1.6x**	**9.1x**	**4.7%**
Median				**1.2x**	**8.5x**	**3.6%**

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

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

**** - Price as at 13/06/2018***

All values in Kshs unless stated otherwise

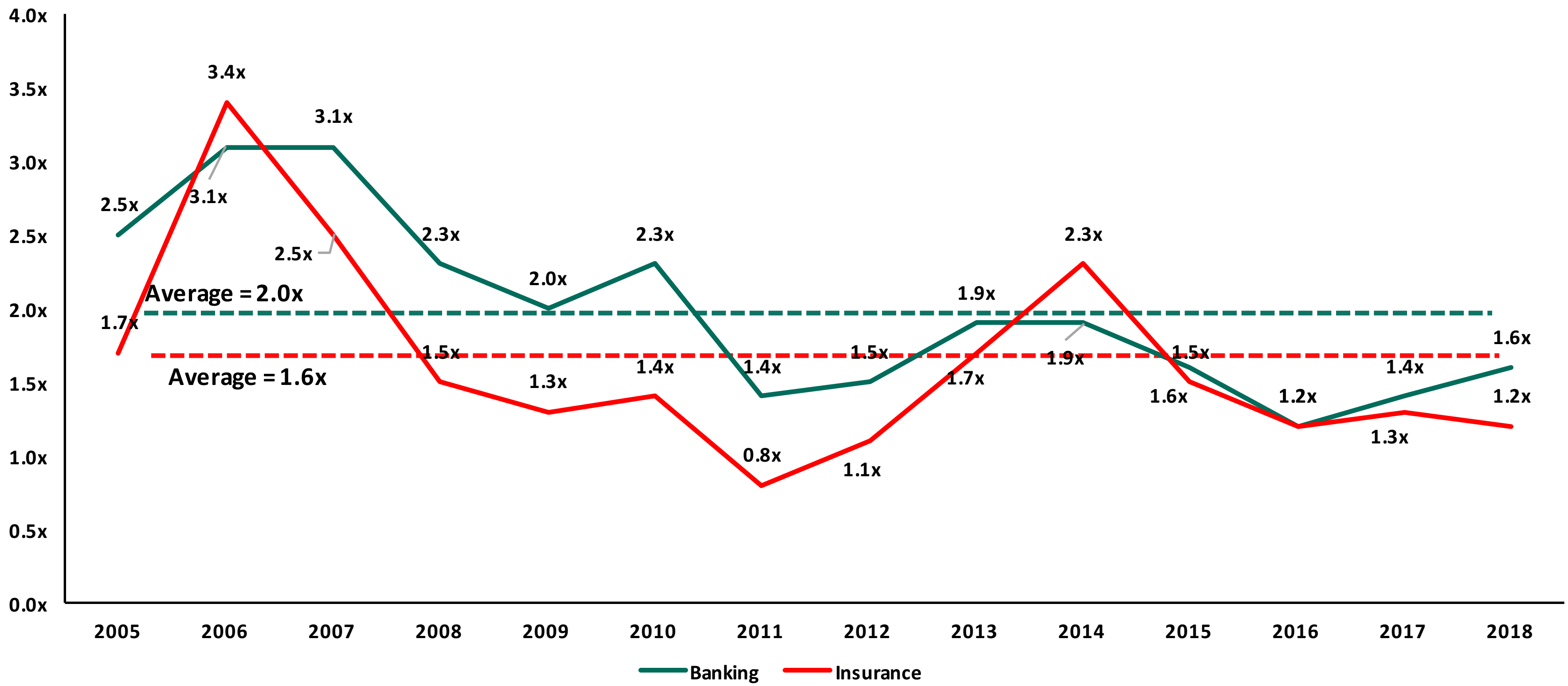
Source: NSE, Cytonn Banking Sector Report

Cytonn INVESTMENTS

Banking Sector Multiples

Listed Banks are currently priced at a PBV of 1.6x, higher than the listed insurance sector at 1.2x

13 year Price to Book Value: Banking and Insurance



On a price to book valuation, listed banks are currently priced at a PBV of 1.6x, higher than listed insurance companies at 1.2x, with both lower than their historical averages of 2.0x for the banking sector and 1.6x for the insurance sector

Source – Cytonn Research

Summary of the Q1'2018 Earnings

Banks have adapted to the regulatory environment following capping of interest rates, with the sector recording a 14.4% increase in core EPS, compared to a decline of 8.6% in Q1'2017

1. The market cap-weighted increase of 14.4% in core earnings in Q1'2018 compared to a market cap weighted decline of 8.6% in Q1'2017 shows that banks are adapting to the regulatory environment after the legislation capping interest rates was passed in the second half of 2016.
2. Deposits grew at a faster rate than loans at 9.4% compared to loans at 3.2%, but grew slower than the 5-year average of 12.7%
3. The level of NPLs remains a concern within the banking sector with the gross non-performing loan (NPL) ratio for the listed banks rising to 13.5%, from 12.1% in Q1'2017. 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

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 Q1'2018 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%)
- During the preparation of this Q1'2018 Banking Sector Report, we shared with the all listed banks the operating metrics that were used in the rankings for their confirmation and verification

Diversification key to growth amid tighter regulation. Asset quality remains a concern

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 a decline in Net Interest Margins due to the price controls, with the Net Interest Margin coming in at 8.1% from 9.2% in Q1'2017, • Banks total capital position relative to their risky assets declined by an average of 0.3% on IFRS 9 implementation. Banks adopted more stringent lending policies, which was skewed towards collateral based lending as opposed to unsecured lending
Diversification	• **Increased diversification to non-funded income revenue streams:** With banks registering compressed net interest margins, much of the attention has shifted to non-funded income, as this section of the bank's revenue is not affected by the interest rate caps.	• Non-Funded Income growth has been emphasized in the new bank's business model, rising by 9.5% in Q1'2018, higher than the 5-year average growth of 8.1%, and has shored up banks income. We believe revenue expansion by product diversification is one of the core opportunities for the banking sector, in the quest to achieve sustainable growth
Asset Quality	• **Increase in non-performing loans:** With the Gross NPL ratio currently at 13.5% from 12.4% in FY'2017, and much higher than the 5-year average of 8.4%. This raises concerns around asset quality in the sector	• The increased NPLs and adoption of IFRS 9 has forced banks to adopt prudent banking based on a more stringent risk assessment framework • This has led to more prudent provisioning by banks, resulting to lower profitability, and we expect this to continue going forward

Diversification proves to be key to growth in the Banking sector, in the wake of a tighter regulated environment, following the capping of interest rates and compliance to the IFRS 9 standard. Deteriorating asset quality remains a concern, which has seen banks reduce lending to the riskier private sector and channel more funds to government securities

Cytonn INVESTMENTS

Rankings by Franchise Value

Equity Group and KCB Group emerged top in the franchise value rankings, with HF Group 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	Q1'18 Rank	FY'17 Rank
1	Equity	8	1	1	3	1	11	10	1	7	8	2	1	7	53	1	2
1	KCB	2	5	2	4	2	9	8	5	4	7	4	2	1	53	1	1
3	I&M	5	3	4	6	6	6	3	8	9	1	3	6	7	62	3	4
4	Barclays	3	9	5	1	8	7	5	3	2	6	9	3	5	63	4	5
4	Co-op	1	4	3	2	4	8	7	6	11	2	5	7	4	63	4	3
6	DTBK	7	6	6	9	3	4	6	2	3	9	11	5	2	66	6	8
7	Stanbic	4	2	9	8	7	5	2	4	6	10	1	4	11	69	7	9
8	SCBK	10	8	7	5	9	10	1	9	1	4	6	8	3	71	8	7
9	NIC	6	7	8	10	5	3	4	7	8	5	8	9	9	83	9	6
10	NBK	9	11	10	7	11	2	11	11	5	11	7	11	6	103	10	10
11	HF Group	11	10	11	11	10	1	9	10	10	3	10	10	9	104	11	11

Key Ranking Metrics

- 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 Group and KCB Group tied in 1st position. Equity Group's ranking was on the back of a high return on average equity of 24.7% compared to an industry average of 13.8%, as well as having the best asset quality and efficiency, with Equity's NPL ratio at 6.5% and Cost to Income ratio at 49.6%
- HF Group ranked 11th, owing to increased costs and low return, with their Cost to Income Ratio and Return on average common equity at 94.6% and 0.7%, respectively, as compared to an industry average of 63.4%, and 13.8%, respectively

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

Source: Cytonn Research

Rankings by Intrinsic Value

NIC Group has the highest upside with a total potential return of 58.6%

Banks	Current Price*	Target Price	Upside (Downside)	Dividend Yield	Total Potential Return	Q1'2018 Ranking	FY'2017 Ranking
NIC Group	34.8	54.1	55.7%	2.9%	**58.6%**	**1**	**1**
Diamond Trust Bank	194.0	280.1	44.4%	1.4%	**45.7%**	**2**	**2**
I&M Holdings	120.0	169.5	41.3%	2.9%	**44.2%**	**3**	**4**
KCB Group	48.5	60.9	25.6%	6.2%	**31.7%**	**4**	**3**
HF Group	8.2	10.2	24.4%	4.3%	**28.7%**	**5**	**10**
Barclays Bank	11.9	14.0	17.7%	8.2%	**25.9%**	**6**	**5**
Co-op Bank	17.5	19.7	12.8%	5.5%	**18.3%**	**7**	**6**
Equity Group	49.3	55.5	12.6%	4.1%	**16.7%**	**8**	**8**
Standard Chartered	200.0	184.3	(7.9%)	8.5%	**0.6%**	**9**	**11**
Stanbic Holdings	93.0	85.9	(7.6%)	5.6%	**(1.9%)**	**10**	**9**
NBK	6.7	2.8	(58.1%)	0.0%	**(58.1%)**	**11**	**7**

Prices as at 13th June 2018

- The Intrinsic Valuation is computed through a combination of valuation techniques, with a weighting of 75.0% on Discounted Cash flow Methods and 25.0% on Relative Valuation
- NIC Group has the highest upside at 58.6%, followed by DTBK and I&M Holdings at 45.7% and 44.2%, respectively
- HF Group rose 5 positions to position 5 from 10 in FY'2017, with an expected return of 28.7%

Composite Bank Ranking

Overall, KCB Group ranked highest, while 7 banks shifted positions from FY'2017

CYTONN'S Q1'2018 BANKING REPORT RANKINGS					
Bank	**Franchise Value Total Score**	**Intrinsic Value Score**	**Weighted Score**	**Q1'2018 Rank**	**FY'2017 Rank**
KCB Group	53.0	4.0	23.6	**1**	**1**
Equity Group	53.0	8.0	26.0	**2**	**2**
I&M Holdings	62.0	3.0	26.6	**3**	**3**
Diamond Trust Bank	66.0	2.0	27.6	**4**	**7**
Barclays Bank	63.0	6.0	28.8	**5**	**6**
Co-operative Bank	63.0	7.0	29.4	**6**	**4**
Stanbic Holdings	69.0	10.0	33.6	**7**	**9**
NIC Group	83.0	1.0	33.8	**8**	**5**
Standard Chartered Bank	71.0	9.0	33.8	**8**	**8**
HF Group	104.0	5.0	44.6	**10**	**11**
National Bank of Kenya	103.0	11.0	47.8	**11**	**10**

- In our ranking, franchise value was assigned a weighting of 40.0% while the intrinsic value was assigned 60.0% weight
- KCB Group maintained the 1st position, while Equity Group and I&M Holdings also maintained the 2nd and 3rd positions from FY'2017
- Diamond Trust Bank rose 3 positions to position 4 from 7th in FY'2017, while NIC Group declined 3 spots to position 8 from 5th in FY'2017

Cytonn INVESTMENTS

Appendices

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 9.6%, with the lowest for HF Group at 5.1%

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 24.7%, while HF Group had the lowest at 0.7%

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, Equity Group and Stanbic Holdings had the lowest PEG ratios at 0.6x, while NBK was the most overvalued at 6.4x

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

Output:

Stanchart has the highest deposits per branch at Kshs 6.4 bn, while NBK had the lowest deposits per branch at Kshs 1.2 bn

Cytonn INVESTMENTS

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 HF Group was the farthest at 133.1%

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. Equity Group maintained the lowest cost to income ratio of 49.6%, while National Bank had the highest ratio at 95.7%

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 found that HF Group was the most undervalued banks as per this metric at 0.2x, while Equity Group is the most overvalued at 2.5x

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:

I &M Holdings is the most solvent with a tangible common ratio of 17.0%, while NBK was the least solvent at 5.1%

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:

Equity Group had the highest quality loan book with a gross non-performing loans ratio of 6.5%, while NBK had the highest non-performing loans ratio at 42.9%

Banking Sector Report – Metrics Used, continued…

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

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

Output:

SCBK has the highest provisions for non-performing loans at 75.2%, while Co-operative Bank has the lowest at 30.6%

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

Output:

We see that Kenyan banks' non-interest income is set to benefit from new initiatives such as banc-assurance and mobile banking. Stanbic Holdings has the highest non-interest income as a percentage of revenue at 49.2%, while Diamond Trust Bank has the lowest at 21.5%.

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

Cytonn INVESTMENTS

B. Tier I Banks

Tier 1 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
Equity Group	• Increased focus on alternative distribution channels, as the bank rides on the digital revolution wave, as evidenced by the increase in the number of transactions done via the Equity Eazzy Banking app • Increased focus on regional expansion as the bank focuses increasing its footprint in regions it has established itself as it aims to diversify across geographies	• N/A
KCB Group	• Alternative channels including mobile banking and agency banking, which currently account for 87.0% of transactions	• Lack of diversity in non-interest income generation as denoted by stagnation in the bank's Non-Funded Income revenue generation. The brand is underutilized in fee income businesses such as investment banking, brokerage, asset and investment management, and advisory
Co-op Bank	• Alternative channels such as the mobile wallet platform, MCoop Cash mobile app, and agency banking will increase the bank's transactional income and operational efficiency, as more customers increase the usage of these platforms	• Deteriorating asset quality as a result of economic slump occasioned by a protracted electioneering period
Standard Chartered	• Revenue diversification strategies, which has seen Standard Chartered partner with Sanlam Kenya Limited to distribute General insurance products • Strong in corporate banking business	• Deteriorating asset quality has 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 as Barclays Plc exits Africa • The bank has a number of initiatives to boost revenue going forward, including growing its bancassurance business and leveraging returns from Barclays Financial Services Ltd (BFSL)	• The bank will continue lagging its peers in the capture of the retail market • Deteriorating asset quality remains a concern
DTB Bank	• Strong backing from financing partners, i.e. Aga Khan Fund for Economic Development and Habib bank • Strong partnerships with firms such as Jubilee Insurance to push NFI growth initiatives in bancassurance business	• Stiff competition in the SME banking market • Deteriorating asset quality, largely attributable to risky lending to Nakumatt, coupled by economic slowdown due to prolonged elections period
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	• Their expansion strategy is limited by the presence of Standard Bank in the region

Cytonn INVESTMENTS

I. Equity Group

Financial Statements Extracts

Equity Group's PAT is expected to grow at a 5-year CAGR of 15.9%

Income Statement	2016	2017	2018e	2019e	2020e	2021e
Net Interest Income	41.8	37.6	40.2	44.4	51.5	59.8
Non Funded Income	22.2	27.6	29.3	32.3	36.8	41.6
Loan Loss Provision	(6.6)	(3.4)	(3.5)	(5.8)	(7.3)	(8.9)
Other Operating Expenses	(20.8)	(23.4)	(36.2)	(40.9)	(46.3)	(52.6)
Total Operating Expenses	**(39.1)**	**(38.3)**	**(36.2)**	**(40.9)**	**(46.3)**	**(52.6)**
Profit Before Tax	24.9	23.3	40.7	35.8	42.0	48.8
Profit After tax	16.6	18.9	23.3	25.0	29.4	34.1
% PAT Change YoY	**(4.2%)**	**14.0%**	**23.2%**	**7.4%**	**17.4%**	**16.1%**
EPS	4.4	5.0	6.2	6.6	7.8	9.0
DPS	2.0	2.0	2.2	2.5	2.8	3.2
Cost to Income	61.1%	58.7%	52.1%	53.4%	52.4%	51.9%
NIM	11.1%	8.9%	8.3%	8.6%	8.6%	8.7%
ROaE	21.5%	21.6%	26.8%	24.9%	24.4%	23.6%
ROaA	3.7%	3.8%	4.5%	4.1%	4.2%	4.3%

Balance Sheet	2016	2017	2018e	2019e	2020e	2021e
Net Loans and Advances	266.1	279.1	289.7	336.4	390.6	453.4
Government Securities	100.6	149.5	143.2	162.8	187.9	214.1
Other Assets	107.1	95.8	139.4	148.3	159.8	176.3
Total Assets	**473.7**	**524.5**	**572.3**	**647.5**	**738.3**	**843.8**
Customer Deposits	337.2	373.1	413.8	473.8	542.5	621.1
Other Liabilities	54.5	58.2	66.5	64.2	64.5	64.8
Total Liabilities	**391.7**	**431.3**	**480.3**	**538.0**	**607.0**	**685.9**
Shareholders Equity	82.0	93.1	92.0	109.5	131.3	157.9
Book value Per share	21.7	24.7	24.4	29.0	34.8	41.8
% Change in BPS YoY	**13.6%**	**13.6%**	**-1.2%**	**19.0%**	**20.0%**	**20.2%**

Cytonn INVESTMENTS

Valuation Summary

Equity Group is undervalued with a total potential return of 16.7%

Cost of Equity Assumptions:	15-Jun-18
Default Spread Adjusted Risk free rate	13.2%*
Beta	0.92
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	18.0%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	18.4%
Return on Average Equity 2022	21.8%
Justified Price to Book value per share	1.8x
Shareholder Equity - FY22e	189.96
Terminal Value-(Year 2021)	349.06

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intergrated DDM	69.2	40.0%	27.7
Residual Income	56.5	35.0%	19.8
PBV Multiple	28.6	20.0%	5.7
PE Multiple	44.7	5.0%	2.2

Fair Value	**55.5**
Current Price	**49.3**
Upside/(Downside)	12.6%
Dividend Yield	4.1%
Total Potential Return	**16.7%**

** 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 5-year CAGR of 11.3%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	47.0	48.4	50.5	56.5	63.0
Non Funded Income	22.5	23.0	23.4	25.3	28.1
Loan Loss Provision	(3.8)	(5.9)	(4.6)	(5.8)	(6.4)
Other Operating Expenses	(36.6)	(36.4)	(39.3)	(43.0)	(47.2)
Total Operating Expenses	**(40.4)**	**(42.3)**	**(43.9)**	**(48.8)**	**(53.6)**
Profit Before Tax	29.1	29.1	30.1	32.9	37.5
Profit After tax	19.7	19.7	21.1	23.0	26.2
% PAT Change YoY	**0.5%**	**(0.1%)**	**6.8%**	**9.5%**	**13.8%**
EPS	6.4	6.4	6.9	7.5	8.6
DPS	3.0	3.0	3.0	3.3	3.8
Cost to Income	58.1%	59.2%	59.3%	59.7%	58.9%
ROE	22.2%	19.5%	19.8%	20.5%	20.7%
ROA	3.4%	3.2%	3.2%	3.3%	3.5%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Net Loans and Advances	385.7	422.7	463.9	508.8	558.1
Government Securities	40.5	38.3	34.6	39.2	45.5
Other Assets	169.0	185.7	215.5	222.6	239.5
Total Assets	**595.2**	**646.7**	**714.0**	**770.6**	**843.1**
Customer Deposits	448.2	499.5	542.3	596.5	653.2
Other Liabilities	50.5	41.2	65.5	54.9	56.1
Total Liabilities	498.7	540.7	607.8	651.5	709.3
Shareholders Equity	96.6	106.0	106.2	119.1	133.8
Book value Per share	31.5	34.6	34.7	38.9	43.6
% Change in BPS YoY	**18.8%**	**9.7%**	**0.3%**	**12.1%**	**12.3%**

Valuation Summary

KCB Group is undervalued with a total potential return of 31.7%

Cost of Equity Assumptions:	14/06/2018
Default Spread Adjusted Risk free rate	13.2%
Beta	0.9
Market Risk Premium	5.2%
Cost of Equity	17.9%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.4%
Return on Average Equity	21.0%
Terminal Price to Book	1.5x
Shareholder Equity - FY22e	147.6
Terminal Value - (Year 2022)	232.4

Valuation Summary	Implied Price	Weighting	Weighted Value
Residual Income	57.5	35%	20.1
PBV Multiple	51.3	20%	10.3
PE Multiple	58.6	5%	2.9
DDM Integrated	69.4	40%	27.8
Target Price			**61.1**
Current Price			**48.5**
Upside/(Downside)			25.6%
Dividend Yield			6.2%
Total Return			**31.7%**

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

Cytonn INVESTMENTS

III. Co-operative Bank of Kenya

Financial Statements Extracts

Co-operative Bank's PAT is expected to grow at a 5-year CAGR of 11.1%

Income Statement	2016	2017	2018f	2019f	2020f	2021f
Net Interest Income	29.5	28.1	28.3	31.9	34.8	39.0
Non Funded Income	12.8	13.5	14.8	16.3	18.0	19.9
Loan Loss Provision	(2.6)	(3.6)	(3.9)	(4.5)	(5.1)	(5.6)
Other Operating Expenses	(12.6)	(11.6)	(10.8)	(12.8)	(14.0)	(15.9)
Total Operating Expenses	(24.6)	(25.3)	(25.6)	(29.0)	(31.5)	(34.8)
Profit Before Tax	17.7	16.4	17.6	19.3	21.4	24.2
Profit After tax	12.7	11.4	12.3	13.5	15.0	17.0
% PAT Change YoY	**8.3%**	**(10.0%)**	**8.2%**	**9.3%**	**11.1%**	**13.2%**
EPS	2.6	2.3	2.5	2.8	3.1	3.5
DPS	1.0	1.0	1.0	1.2	1.3	1.5
Cost to Income	58.3%	60.9%	59.4%	60.2%	59.6%	59.0%
NIM	9.9%	8.8%	8.5%	8.4%	8.3%	8.4%
ROE	22.7%	17.4%	18.5%	17.7%	17.6%	17.8%
ROA	3.7%	3.1%	3.2%	3.1%	3.1%	3.2%

Balance Sheet	2016	2017	2018f	2019f	2020f	2021f
Net Loans and Advances	236.9	253.9	268.8	299.3	334.2	369.5
Government Securities	61.9	72.7	85.7	85.2	95.8	110.4
Other Assets	53.0	60.3	64.1	72.5	76.6	80.2
Total Assets	**351.9**	**386.9**	**418.6**	**457.0**	**506.6**	**560.2**
Customer Deposits	279.8	287.4	304.7	341.3	380.5	422.4
Other Liabilities	10.9	29.2	41.0	34.5	35.5	36.8
Total Liabilities	**290.7**	**316.6**	**345.7**	**375.8**	**416.1**	**459.2**
Shareholders Equity	61.3	69.6	72.1	80.5	89.8	100.3
Book value Per share	12.5	14.2	14.8	16.5	18.4	20.5
% Change in BPS YoY	**22.1%**	**13.5%**	**3.7%**	**11.6%**	**11.5%**	**11.7%**

Cytonn INVESTMENTS

Valuation Summary

Co-operative Bank is undervalued with a total potential return of 18.3%

Cost of Equity Assumptions:	15-Jun-18
Default Spread Adjusted Risk free rate	13.2%*
Beta	1.02
Mature Market Risk Premium	6.4%
Extra Risk Premium	0.3%
Cost of Equity	19.98%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	19.85%
Return on Average Equity 2020	17.8%
Justified Price to Book value per share	0.9x
Shareholder Equity - FY20e	100.27
Terminal Value-(Year 2020)	86.71

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	21.45	40%	8.58
Residual income	19.05	35%	6.67
PBV Multiple	18.60	20%	3.72
PE Multiple	16.90	5%	0.84
Fair Value			**19.8**
Current Price			**17.5**
Upside/(Downside)			12.8%
Dividend Yield			5.5%
Total Return			**18.3%**

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

Cytonn INVESTMENTS

IV. Standard Chartered Bank

Financial Statements Extracts

Standard Chartered's PAT is expected to grow at a 5-year CAGR of 5.5%

Income Statement	**2016**	**2017**	**2018f**	**2019f**	**2020f**
Net Interest Income	19.4	18.6	19.7	21.2	22.5
Non Funded Income	8.6	8.8	9.3	9.6	10.5
Loan Loss Provision	(2.2)	(4.2)	(4.1)	(4.3)	(4.8)
Other Operating Expenses	(12.5)	(13.1)	(13.6)	(14.4)	(15.4)
Total Operating Expenses	**14.7**	**17.3**	**17.7**	**18.7**	**20.1**
Profit Before Tax	13.3	10.1	11.4	12.1	12.9
Profit After tax	9.1	6.9	6.9	7.2	7.7
% PAT Change YoY	**42.7%**	**(23.6%)**	**(0.9%)**	**5.6%**	**6.6%**
EPS	26.3	20.1	19.9	21.1	22.5
DPS	20.0	17.0	17.0	13.7	14.6
Cost to Income	52.5%	63.2%	60.7%	60.8%	61.0%
NIM	9.6%	7.9%	7.7%	7.9%	7.7%
ROaE	21.3%	15.4%	15.0%	15.5%	15.6%
ROaA	3.7%	2.6%	2.3%	2.3%	2.3%
Balance Sheet	**2016**	**2017**	**2018f**	**2019f**	**2020f**
Net Loans and Advances	122.7	126.3	130.0	140.4	156.6
Government Securities	86.9	110.5	115.8	128.7	141.8
Other assets	40.7	48.9	53.1	54.3	54.3
Total Assets	**250.3**	**285.7**	**299.0**	**323.4**	**352.7**
Customer Deposits	186.6	213.3	236.4	260.1	284.8
Other Liabilities	19.8	26.7	17.1	15.4	17.3
Total Liabilities	**206.4**	**240.1**	**253.5**	**275.5**	**302.1**
Shareholders Equity	43.9	45.7	45.4	48.0	50.7
Book value Per share	127.8	132.9	132.3	139.6	147.5
% Change in BPS YoY	**6.4%**	**4.0%**	**(0.5%)**	**5.6%**	**5.6%**

Valuation Summary

Standard Chartered Bank is fairly valued with a total potential return of 0.6%

Cost of Equity Assumptions:	14-Jun-18
Default Spread adjusted Risk free rate	13.2%
Beta	80.0%
Country Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	17.4%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.00
Terminal Cost of Equity	18.4%
Return on Average Equity	16.8%
Terminal P/B	1.5x
Shareholder Equity - FY22e	56.8
Terminal Value-(Year 2022)	84.5

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	178.2	40%	71.3
Residual Income	183.8	35%	64.3
PBV Multiple	209.7	20%	41.9
PE Multiple	160.7	5%	8.0

Fair Value	**185.6**
Current Price	**200.0**
Upside/(Downside)	(7.9%)
Dividend Yield	8.5%
Total Return	**0.6%**

** 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 6.9%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	22.3	21.8	22.2	23.9	25.3
Non Funded Income	9.3	8.5	8.9	9.5	10.1
Loan Loss Provision	(3.9)	(3.1)	(2.6)	(3.5)	(3.9)
Other Operating Expenses	(16.9)	(16.8)	(17.8)	(19.2)	(20.4)
Total Operating Expenses	**(20.8)**	**(19.9)**	**(20.4)**	**(22.6)**	**(24.3)**
Profit Before Tax	10.9	10.4	10.7	10.8	11.0
Profit After tax	**7.4**	**6.9**	**7.5**	**7.5**	**7.7**
% PAT Change YoY	**(11.9%)**	**(6.4%)**	**8.1%**	**0.5%**	**2.6%**
EPS	1.4	1.3	1.4	1.4	1.4
DPS	1.0	1.0	1.0	1.0	1.0
Cost to Income	65.7%	65.8%	65.6%	67.8%	68.8%
NIM	10.5%	9.7%	9.4%	9.6%	9.5%
ROaE	18.0%	16.0%	16.9%	16.6%	16.2%
ROaA	3.0%	2.7%	2.9%	2.7%	2.7%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Net Loans and Advances	168.5	168.4	173.5	185.0	198.1
Government Securities	48.7	58.5	61.2	64.9	69.1
Other Assets	42.5	44.3	68.6	65.5	65.1
Total Assets	**259.7**	**271.2**	**303.3**	**315.4**	**332.4**
Customer Deposits	178.2	186.0	204.1	216.3	230.4
Other Liabilities	39.1	41.1	54.7	52.6	53.2
Total Liabilities	**217.3**	**227.1**	**258.8**	**268.9**	**283.6**
Shareholders Equity	42.4	44.1	44.4	46.5	48.8
Book value Per share	7.8	8.1	8.2	8.6	9.0
% Change in BPS YoY	**6.7%**	**4.0%**	**0.7%**	**4.7%**	**4.9%**

Valuation Summary

Barclays Bank Kenya is undervalued with a total potential return of 25.9%

Cost of Equity Assumptions:	14-Jun-18
Risk free rate *	13.2%
Beta	0.9
Country Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	19.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.00
Terminal Cost of Equity	18.4%
Return on Average Equity	18.5%
Terminal Price to Book value per share	1.5x
Shareholders Equity FY 22e	55.7
Terminal Value (Year 2022e)	87.7

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	11.4	40%	4.6
Residual Income	17.6	35%	6.2
PBV Multiple	13.1	20%	2.6
PE Multiple	11.0	5%	0.6

Fair Value	**14.0**
Current Price	**11.9**
Upside/(Downside)	17.7%
Dividend Yield	8.2%
Total Return	**25.9%**

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

VI. Diamond Trust Bank

Financial Statement Extracts

DTB has an estimated 5-year PAT CAGR of 10.0%

Income Statement	2016	2017	2018f	2019f	2020f
Net Interest Income	19.4	19.7	21.5	23.4	26.2
Non Funded Income	5.1	5.3	5.7	6.3	7.0
Loan Loss Provision	(4.3)	(4.3)	(5.0)	(5.5)	(6.1)
Other Operating Expenses	(5.8)	(6.6)	(7.4)	(8.0)	(9.0)
Total Operating Expenses	**(13.5)**	**(14.9)**	**(16.6)**	**(18.2)**	**(20.2)**
Profit Before Tax	11.0	10.1	10.7	11.5	13.0
Profit After tax	7.7	6.9	7.5	8.1	9.1
% PAT Change YoY	**17.0%**	**(10.3%)**	**7.9%**	**7.8%**	**12.7%**
EPS	27.6	24.8	26.3	28.4	32.0
DPS	2.6	2.6	2.8	3.0	3.4
Cost to Income	55.1%	59.6%	60.9%	61.3%	61.0%
NIM	**7.4%**	**6.5%**	**6.5%**	**6.4%**	**6.4%**
ROE	20.5%	13.9%	14.3%	13.7%	13.6%
ROA	2.6%	2.0%	1.9%	1.9%	2.0%
Balance Sheet	**2016**	**2017**	**2018f**	**2019f**	**2020f**
Net Loans and Advances	186.3	196.0	216.5	240.6	267.6
Government Securities	92.8	112.5	113.1	129.3	143.8
Other Assets	49.0	54.7	66.3	59.7	66.5
Total Assets	**328.0**	**363.3**	**395.9**	**429.6**	**477.9**
Customer Deposits	238.1	266.2	289.3	324.1	362.9
Other Liabilities	44.1	43.4	46.8	38.7	40.1
Total Liabilities	**282.2**	**309.7**	**336.2**	**362.8**	**403.0**
Shareholders Equity	41.0	48.4	54.6	61.7	69.7
Book value Per share	146.7	173.0	195.2	220.6	249.2
% Change in BPS YoY	**14.5%**	**17.9%**	**12.8%**	**13.0%**	**13.0%**

Source – Company Financials

Cytonn INVESTMENTS

Valuation Summary

DTB's stock is undervalued with a total potential return of 45.7%

Cost of Equity Assumptions:	15-Jun-18
Risk free rate *	13.2%
Beta	0.8
Country Risk Premium	5.2%
Extra Risk Premium	1.5%
Cost of Equity	18.8%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.9%
Return on Average Equity	13.5%
Justified Price to Book value per share	1.5x
Shareholder Equity - FY22e	88.57
Terminal Value-(Year 2022)	139.49

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	272.8	35.0%	95.5
DDM Integrated	284.7	40.0%	113.9
PBV Multiple	299.0	20.0%	59.8
PE Multiple	223.6	5.0%	11.2

Fair Value	**280.1**
Current Price	**194.0**
Upside/(Downside)	44.4%
Dividend yield	1.4%
Total return	**45.7%**

** 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 6.0%

Income Statement	2016	2017	2018e	2019e	2020e	2021e
Net Interest Income	10.9	10.6	10.8	11.0	11.8	12.6
Non Funded Income	7.7	8.4	9.8	11.0	12.5	13.6
Loan Loss Provision	(1.8)	(2.8)	(3.4)	(3.7)	(4.5)	(5.0)
Total Operating Expenses	**(12.5)**	**(13.7)**	**(14.5)**	**(15.4)**	**(17.0)**	**(18.4)**
Profit Before Tax	6.0	5.4	6.1	6.6	7.3	7.8
Profit After tax	4.4	4.3	4.3	4.6	5.1	5.5
% PAT Change YoY	**(9.9%)**	**(2.5%)**	**(0.6%)**	**(8.1)%**	**10.4%**	**7.5%**
EPS	11.2	10.9	10.8	11.7	12.9	13.9
DPS	5.3	5.3	5.3	5.3	5.3	5.3
Cost to Income	57.9%	57.2%	54.0%	53.0%	51.5%	51.0%
NIM	**5.9%**	**5.2%**	**4.5%**	**4.2%**	**4.1%**	**4.1%**
ROaE	11.3%	10.4%	9.7%	10.0%	10.4%	10.5%
ROaA	2.1%	1.9%	1.6%	1.6%	1.7%	1.7%

Balance Sheet	2016	2017	2018e	2019e	2020e	2021e
Net Loans and Advances	132.6	143.3	162.9	175.3	192.5	207.7
Other Assets	82.1	105.5	115.8	122.4	127.9	131.8
Total Assets	**214.7**	**248.7**	**278.7**	**297.6**	**320.3**	**339.5**
Customer Deposits	155.8	193.4	220.7	236.1	252.7	272.9
Borrowings	4.0	4.0	4.0	4.0	4.0	4.0
Other Liabilities	14.7	8.4	8.8	9.8	12.9	8.4
Total Liabilities	**174.5**	**205.8**	**233.5**	**249.9**	**269.6**	**285.3**
Shareholders Equity	40.1	43.0	45.2	47.7	50.8	54.2
Book value Per share	101.5	108.7	114.2	120.7	128.4	137.0
% Change in BVPS	**4.6%**	**7.0%**	**5.1%**	**5.7%**	**6.4%**	**6.7%**

Valuation Summary

Stanbic Holdings is slightly overvalued with a total potential downside of 1.9%

Cost of Equity Assumptions:	15-Jun-18
Default Spread Adjusted Risk free rate	13.2%
Raw Beta	0.8
Mature Market Risk Premium	5.2%
Extra Risk Premium	1.0%
Cost of Equity	18.3%
Adjusted Beta	**0.9**

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.00
Terminal Cost of Equity	19.40%
Return on Average Equity	10.3%
Persistency Factor	0.50
Justified Price to Book value per share	1.0x

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	90.8	40%	36.3
DDM Integrated	88.7	35%	31.0
PBV Multiple	72.1	20%	14.4
PE Multiple	83.3	5%	4.2

Fair Value	**85.9**
Current Price	**93.0**
Dividend Yield	**5.6%**
Upside/(Downside)	**(1.9%)**

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

Cytonn INVESTMENTS

C. Tier II Banks

Tier 2 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
National Bank	• Introduction of Islamic Banking and the SME banking units. The SME products inlude Jenga Chama, Jenga Kilimo and Jenga Biashara • The introduction of bancassurance and custodial services has seen the bank diversify its revenue	• Capital ratios are below the regulatory requirement. However, their major shareholders have firm commitments to inject additional capital in order to meet the statutory capital requirements
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	• The bank has a high cost of funds of 5.2% above the Tier I and II average of 3.1%, as it mobilizes expensive deposits which it is unable to deploy • NIC Group is really performing below its potential on fee income businesses, with total fees rising a mere 1.8%, and this should be a key area of focus to improve profitability
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 • Acquisitions are contributing positively to their NFI growth	• 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 23.1%

Income Statement	2016	2017	2018e	2019f	2020f	2021f	2022f
Net Interest Income	7.8	6.7	6.3	6.8	7.5	8.1	8.6
Non Funded Income	2.9	2.4	2.5	2.5	2.8	2.9	3.1
Loan Loss Provision	2.4	0.8	0.8	1.0	1.1	1.1	1.1
Other Expenses	8.2	7.6	7.2	7.6	8.1	8.6	9.0
Total Operating Expenses	**10.6**	**8.4**	**8.0**	**8.6**	**9.1**	**9.8**	**10.1**
Profit Before Tax	0.1	0.8	0.3	0.7	1.1	1.3	1.7
Profit After tax	**0.1**	**0.4**	**0.2**	**0.5**	**0.8**	**0.9**	**1.2**
% PAT Change YoY	**(106.2%)**	**479.0%**	**(49.9%)**	**146.8%**	**56.8%**	**17.7%**	**24.1%**
EPS	0.2	1.2	0.6	1.5	2.4	2.8	3.4
DPS	-	-	-	-	-	-	-
Cost to Income	76.6%	83.2%	81.6%	81.6%	78.6%	77.6%	76.6%
NIM	8.2%	7.4%	7.0%	7.1%	7.2%	7.3%	7.2%
ROaE	0.8%	5.8%	2.9%	7.1%	10.1%	10.7%	11.9%
ROaA	0.1%	0.4%	0.2%	0.4%	0.7%	0.7%	0.8%

Balance Sheet	2016	2017	2018e	2019f	2020f	2021f	2022f
Net Loans and Advances	55.0	52.4	52.6	57.2	61.2	65.5	70.1
Government Securities	34.5	35.7	36.1	41.0	43.9	46.9	50.2
Other Assets	22.5	21.8	20.3	20.3	19.1	20.5	22.0
Total Assets	112.1	109.9	109.0	118.6	124.2	132.9	142.3
Customer Deposits	93.9	94.3	89.1	95.4	102.0	109.2	116.8
Other Liabilities	11.3	8.4	12.9	15.7	14.0	14.5	15.2
Total Liabilities	105.2	102.6	102.0	111.1	116.0	123.7	132.0
Shareholders Equity	6.9	7.2	6.9	7.5	8.3	9.2	10.4
Book value Per share	20.4	21.4	20.5	22.0	24.4	27.1	30.6
% Change in BVPS	**(37.5%)**	**4.7%**	**(4.0%)**	**7.3%**	**10.7%**	**11.4%**	**12.7%**

Cytonn INVESTMENTS

Valuation Summary

National Bank is overvalued with a total potential downside of 58.1%

Cost of Equity Assumptions:	
Default Spread Adjusted Risk free rate	13.2%
Beta	1.1
Mature Market Risk Premium	5.2%
Extra Risk Premium	2.5%
Cost of Equity	21.7%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.9%
Return on Average Equity	5.2%
Terminal P/B	0.5x
Shareholder Equity - FY22e	10.6
Terminal Value-(Year 2022)	5.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
Common Ratio	5.20	0%	0.00
Residual Income	(2.95)	40%	-1.18
PBV Multiple	5.75	35%	2.01
PE Multiple	7.91	25%	1.98
Fair Value			**2.8**
Current Price			**6.7**
Upside/(Downside)			**(58.1%)**

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

Cytonn INVESTMENTS

II. NIC Group

Financial Statements Extracts

NIC Group's PAT is expected to grow at a CAGR of 7.0%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	12.2	10.8	12.6	13.6	14.5
Non Funded Income	4.0	4.2	4.4	4.7	5.1
Loan Loss Provision	(3.7)	(3.0)	(3.8)	(4.2)	(4.6)
Other operating expenses	(3.0)	(3.2)	(3.7)	(4.0)	(4.3)
Total Operating Expenses	(10.0)	(9.3)	(10.9)	(11.6)	(12.5)
Profit Before Tax	6.2	5.6	6.1	6.6	7.1
Profit After tax	4.3	4.1	4.3	4.6	5.0
% PAT Change YoY	**(3.3%)**	**(4.3%)**	**3.5%**	**7.9%**	**7.6%**
EPS	6.8	6.5	6.7	7.2	7.8
DPS	1.3	1.0	1.1	1.1	1.1
Cost to Income	61.9%	62.5%	63.9%	63.8%	63.7%
NIM	8.0%	6.3%	6.5%	6.6%	6.5%
ROE	15.5%	12.9%	11.5%	10.9%	10.7%
ROA	2.6%	2.2%	2.0%	2.0%	2.0%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	114.5	119.8	134.5	144.6	162.7
Government Securities	30.5	54.2	55.8	58.0	63.8
Other Assets	24.5	32.2	30.7	33.1	36.7
Total Assets	**169.5**	**206.2**	**220.9**	**235.7**	**263.2**
Customer Deposits	111.8	138.9	152.8	168.1	184.9
Other Liabilities	27.3	32.5	27.0	22.5	28.9
Total Liabilities	**139.1**	**171.5**	**179.8**	**190.6**	**213.8**
Shareholders Equity	29.8	34.2	40.7	44.6	48.9
Book value Per share	6.12	7.03	8.35	9.16	10.04
% Change in BVPS	**15.4%**	**14.8%**	**18.8%**	**9.7%**	**9.6%**

Valuation Summary

NIC Group is undervalued with a total potential return of 58.6%

Cost of Equity Assumptions:	14-Jun-18
Risk free rate *	13.2%
Beta	0.9
Country Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	18.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.4%
Return on Average Equity	10.5%
Justified Price to Book value per share	1.3x
Shareholder Equity - FY22e	45.8
Terminal Value-(Year 2022)	60.1

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	62.5	40%	25.0
Residual Valuation	47.0	35%	16.5
PBV Multiple	53.0	20%	10.6
PE Multiple	41.1	5%	2.1
Fair Value			**54.1**
Current Price			**34.8**
Upside/(Downside)			55.7%
Dividend Yield			2.9%
Total Potential Return			**58.6%**

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

IV. HF Group

Financial Statements Extracts

HF Group's PAT is expected to grow at a 5-year CAGR of 7.9%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	3.9	3.0	2.6	2.1	2.2
Non Funded Income	0.8	1.3	1.6	1.8	2.1
Loan Loss Provision	(0.7)	(0.6)	(0.7)	(0.7)	(0.7)
Other operating expenses	(1.6)	(2.3)	(2.2)	(2.0)	(2.1)
Total Operating Expenses	(3.3)	(4.0)	(4.0)	(3.8)	(4.1)
Profit Before Tax	1.4	0.3	0.2	0.1	0.2
Profit After tax	0.9	0.1	0.1	0.1	0.1
% PAT Change YoY	**(24.3%)**	**(86.1%)**	**(8.2%)**	**(9.8%)**	**3.7%**
EPS	2.6	0.3	0.3	0.3	0.3
DPS	0.5	0.1	0.1	0.1	0.1
Cost to Income	56.3%	78.9%	79.2%	79.3%	78.7%
NIM	6.5%	5.2%	4.6%	3.9%	3.8%
ROE	8.3%	1.1%	1.0%	0.9%	0.9%
ROA	1.3%	0.2%	0.2%	0.1%	0.1%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	54.5	49.6	50.3	52.0	54.3
Government Securities	4.1	2.3	2.8	1.9	2.2
Other Assets	0.0	0.0	0.0	0.0	0.0
Total Assets	71.9	67.5	68.9	70.9	73.8
Customer Deposits	38.1	36.7	37.7	39.8	42.0
Other Liabilities	0.0	0.0	0.0	0.0	0.0
Total Liabilities	60.6	56.1	57.5	59.5	62.3
Shareholders Equity	11.3	11.4	11.4	11.4	11.5
Book value Per share	32.0	29.5	29.3	29.5	29.7
% Change in BVPS	**5.2%**	**(7.8%)**	**(0.8%)**	**0.7%**	**0.8%**

Valuation Summary

HF Group is overvalued with a negative total potential return of 28.7%

Cost of Equity Assumptions:	14-Jun-18
Default Spread Adjusted Risk free	13.2%
Beta	0.9
Country Risk Premium	5.2%
Extra Risk Premium	1.50%
Cost of Equity	19.3%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.00
Terminal Cost of Equity	19.9%
Return on Average Equity	1.6%
Terminal Price to Book value per share	0.6x
Shareholder Equity - FY21e	11.8
Terminal Value - (Year 2022)	7.4

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	10.7	40%	4.3
Residual Income	10.3	35%	3.6
PTBV Multiple	9.8	20%	2.0
PE Multiple	7.1	5%	0.4
Fair Value			**10.2**
Current Price			**8.2**
Upside/(Downside)			24.4%
Dividend Yield			4.3%
Total return			**28.7%**

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

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	2016	2017	2018f	2019f	2020f
Net Interest Income	15.5	15.6	16.3	17.2	19.1
Non Funded Income	5.2	5.8	5.4	5.9	6.4
Loan Loss Provision	3.0	4.1	3.5	3.7	4.0
Other Operating Expenses	7.2	7.8	8.3	8.7	9.4
Total Operating Expenses	**10.2**	**12.0**	**11.9**	**12.4**	**13.4**
Profit Before Tax	10.6	9.9	10.3	11.3	12.6
Profit After tax	7.8	7.3	7.2	7.9	8.8
EPS	**19.8**	**18.5**	**18.4**	**20.1**	**22.5**
% PAT Change YoY	**8.6%**	**(6.4%)**	**(0.5%)**	**9.2%**	**12.1%**
EPS	19.8	18.5	18.4	20.1	22.5
DPS	3.5	3.5	3.5	3.5	3.5
CIR	34.7%	36.8%	38.5%	37.6%	37.0%
NIM	8.6%	7.8%	7.3%	7.1%	7.3%
ROaE	21.3%	17.9%	15.5%	15.1%	14.9%
ROaA	3.6%	3.2%	2.8%	2.9%	3.0%
Balance Sheet	**2016e**	**2017f**	**2018f**	**2019f**	**2020f**
Investment Securities	45.8	50.8	58.6	63.2	68.0
Net Loans and Advances	134.7	153.0	168.4	179.3	190.9
Other Assets	30.1	36.2	45.3	46.6	53.3
Total Assets	**210.5**	**240.1**	**268.0**	**284.7**	**307.9**
Customer Deposits	146.5	169.3	189.2	203.8	219.4
Other Liabilities	24.5	23.8	31.3	26.9	26.9
Total Liabilities	**171.0**	**193.1**	**216.1**	**230.7**	**246.4**
Shareholders Equity	37.0	44.3	49.0	55.6	63.0
Book value Per share	0.1	0.1	0.1	0.1	0.2
% BVPS Change YoY	**17.7%**	**19.7%**	**10.7%**	**13.3%**	**13.4%**

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Valuation Summary

I&M Holdings is undervalued with a total potential return of 54.4%

Cost of Equity Assumptions:	15/06/2018
Default Spread Adjusted Risk free rate	13.2%
Beta	0.9
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.5%
Cost of Equity	18.3%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	18.9%
Return on Average Equity 2022	13.4%
Justified Price to Book value per share	1.3x
Shareholder Equity - FY22e	80,149.37
Terminal Value-(Year 2022)	105,196.05

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	209.80	40%	81.92
Residual income	179.73	35%	62.91
PBV Multiple	105.64	20%	21.13
PE Multiple	116.06	5%	5.80
Fair Value			**169.5**
Current Price			**120.0**
Upside/(Downside)			41.3%
Dividend yield			2.9%
Total return			**54.4%**

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

Feedback Summary

During the preparation of this Q1'2018 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
Co-operative Bank of Kenya	Yes	Yes
NIC Group	Yes	Yes
Diamond Trust Bank Kenya	Yes	Unresponsive
KCB Group	Yes	Unresponsive
National Bank of Kenya	Yes	Unresponsive
Standard Chartered Bank Kenya	Yes	Unresponsive
Housing Finance Group	Yes	Unresponsive
Stanbic Holdings	Yes	Unresponsive
I&M Holdings	Yes	Unresponsive
Barclays Bank of 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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