Kenya Listed Commercial Banks Review
Cytonn FY'2019 Banking Sector Report

"Increased Consolidation in the Banking Sector"

Cytonn

19th April, 2020

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I. Introduction to Cytonn

Cytonn

About Us

Cytonn Investments is an alternative investment manager, with real estate development capability, and a primary focus on private equity and real estate investments in the high growth Kenyan Region. Cytonn has a unique strategy of coupling two compelling demand areas - the lack of high yielding investment products and the lack of institutional grade real estate. We provide high yielding investment instruments to attract funding from investors, and we deploy that funding to largely pre-sold investment grade real estate. With offices in Kenya and Washington, DC - USA, we are primarily focused on offering alternative investment solutions to global and local institutional investors, individual high net-worth investors, and diaspora investors interested in the East-African region. Real estate investments are made through our development affiliate, Cytonn Real Estate, where we currently have over Kshs. 82 billion (USD 820 mn) of projects under mandate across ten projects. In private equity, we invest in banking, education, and hospitality.

82	Over Kshs. 82 billion worth of projects under mandate	**7**	Seven offices across 2 continents	**500**	Over 500 staff members, including Cytonn Distribution	**10**	10 investment ready projects in real estate

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 Cytonn Real Estate, our 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 CLIENT SEGMENTS:

- High Net-worth Individuals through Cytonn Private Wealth. This is done through our captive Distribution Network
- East Africans in the Diaspora through Cytonn Diaspora
- Global and Local Institutional Clients. These clients are served from our Investment & Fundraising Team

WE INVEST OUR CLIENT FUNDS IN:

- Real Estate, and Real Estate Related Businesses
- Private Equity
- Fixed Income Structured Solutions
- Equities Structured Solutions

We collect funds from our clients → **We invest them in high growth opportunities** → **We deliver the best possible returns**

Our Business Structure

Cytonn Investments Management Plc

- **Cytonn Capital Partners** (Private Markets)
  - Private Offers and Real Estate Investments
  - Cytonn Hospitality
  - Superior Homes Kenya
- **Cytonn Asset Managers** (Regulated by CMA & RBA)
  - Unit Trust Funds
  - Cytonn Africa Financial Fund
  - Cytonn Advisory
  - Pension Fund Management
- **Cytonn Real Estate**
  - Research and Deal Origination
  - Project Management
  - Quality Assurance/ Control
  - Cytonn Procurement - Cymatt
  - Cytonn Real Estate Legal
  - Cytonn Properties
  - Cytonn Centre for Affordable Housing
- **Other Strategic Initiatives**
  - Cytonn Distribution
  - East African Forum for Alternative Investments

II. Kenya Economic Review and Outlook

Kenya Macro-Economic Review

Of the 7 indicators we track, 1 is positive, 2 are neutral and 4 are negative. We have switched our outlook on 2020 macroeconomic environment from positive to negative depending on how fast the Coronavirus is contained

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicators	**YTD 2020 Experience and Outlook Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
Government Borrowing	• As per the Budget Policy Statement, the fiscal deficit for FY2019/20 was estimated at 6.3% of GDP and although the government continues to pursue the fiscal consolidation policy, risks abound from possible reallocation of funds in a bid to contain the spread of the Coronavirus. This is expected to further widen the fiscal deficit away from the projected decline to 4.9% of GDP in FY 2020/21. On the other hand, the Government raised its net domestic borrowing target by 34.7% to Kshs 404.4 bn for FY'2019/20 from 300.3 bn which it cannot meet given the current market conditions and thus exert pressure on the domestic borrowing front to plug in the deficit. • The government may also find it hard to access foreign debt due to uncertainty affecting the global markets which might see investors attaching a high-risk premium on the country.	Negative	Negative
Inflation	• Inflation for the month of March came in at 6.1%, bringing the m/m increase to 0.2%. Y/Y inflation increased mainly driven by an 11.9% increase in the food and non-alcoholic beverages index. • There are expectations of inflationary pressure emanating from the effects of the world Pandemic-Coronavirus, driven by supply-side shortages owing to lockdowns across the globe which have disrupted supply chains, further heightening cost-push inflation.	Positive	Neutral

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Kenya Macro-Economic Review

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Macro-Economic & Business Environment Outlook			
Macro-Economic Indicators	**YTD 2020 Experience and Outlook Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
Exchange Rate	• The Kenya Shilling has depreciated by 4.3% YTD, in comparison to the 0.5% appreciation in 2019. In our view, the shilling should remain relatively stable against the dollar with a bias to a 2.4% depreciation by the end of 2020, with the sentiments being on the back of; i. Rising uncertainties in the global market due to the Coronavirus outbreak, which has seen the disruption of global supply chains. The shortage of imports from China for instance, which accounts for an estimated 21.0% of the country's imports, is likely to cause local importers to look for alternative import markets, which may be more expensive and as such higher demand for the dollar from merchandise importers	**Neutral**	**Negative**
GDP	• The key sectors of the economy affected by the Coronavirus pandemic include the Tourism, Agricultural, and Manufacturing sectors which were hit the hardest hit due to shutdowns in major markets and the disruption of the global supply chain. Combined, the 3 sectors account for 43.8% of Kenya's GDP in 2018. • Based on the impacts witnessed so far, we believe that Coronavirus may have a 10.0% to 25.0% impact on GDP growth for the year 2020. The 10.0% impact is an optimistic case in the event the outbreak is contained, and a 25.0% impact in the event it is not contained. As such, the coronavirus could reduce Kenya's GDP growth to a range of 1.4% to 1.8% for the year 2020 depending on the severity of the outbreak and economic implications for Kenya.	**Neutral**	**Negative**

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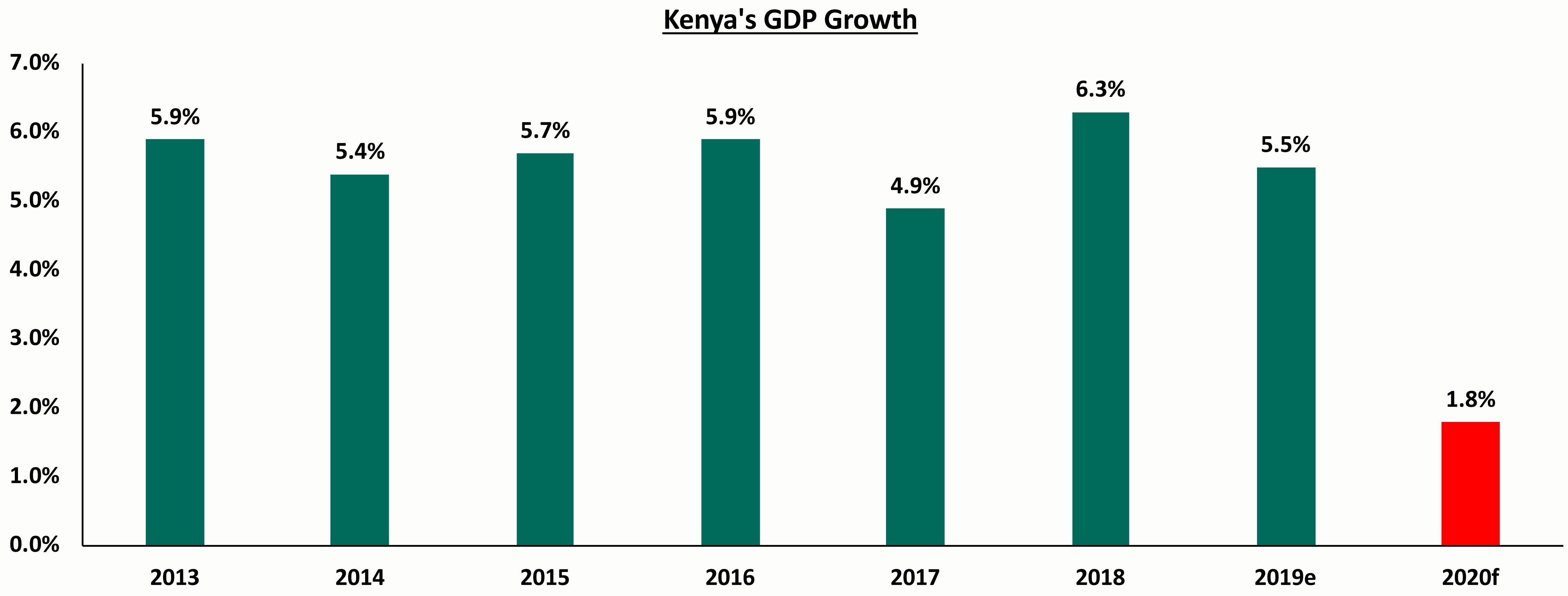
Impact Of COVID-19 On Kenyan GDP Growth

Kenya’s economic growth is expected to decline following the negative effects emanating from COVID-19



**Source: Median of revised estimates*

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Impact Of COVID-19 On Kenyan GDP Growth

Global research houses downgraded their GDP growth estimates for 2020 once as they factored in the economic impact of Coronavirus.

Kenya 2020 Annual GDP Growth Outlook			
No.	Organization	Estimate at the Beginning of 2020	Estimate at end of Q1’2020*
1	**International Monetary Fund**	**6.00%**	**1.00%**
2	**Cytonn Investments Management PLC**	**5.70%**	**1.60%**
3	**McKinsey & Company**	**5.20%**	**1.90%**
4	**Central Bank of Kenya**	**6.20%**	**3.40%**
5	United Nations Conference on Trade and Development (UNCTAD)	5.50%	5.50%
6	Capital Economics	5.90%	5.90%
7	African Development Bank	6.00%	6.00%
8	World Bank	6.00%	6.00%
9	National Treasury	6.00%	6.00%
10	African Development Bank (AfDB)	6.00%	6.00%
11	Citigroup Global Markets	6.20%	6.20%
	Entire Average	**5.88%**	**4.50%**
	Median of Revised Growth Estimates		**1.75%**

**Only those in bold have revised estimated post COVID-19*

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Kenya Macro-Economic Review

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Macro-Economic & Business Environment Outlook			
Macro-Economic Indicators	**YTD 2020 Experience and Outlook Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
Interest Rates	• The interest rate environment has remained stable in 2020, with the MPC having cut the CBR rate by 125 bps cumulatively to 7.25% in the 2 MPC meetings held so far in 2020. • We, however, expect upward pressure on interest rates to emanate from increased pressure on Government borrowing from both the domestic and foreign front especially with the government recently raising the domestic borrowing target from 300.3 bn to 404.4 bn. As the business environment becomes more challenging, we expect a dip in tax revenues, despite the Government being in dire need of raising finances to offer the requisite financial stimulus. This might require the deficit to be plugged in by debt, which might be hard and expensive in the current market conditions due to investors attaching a higher risk premium	**Neutral**	**Negative**
Investor Sentiment	• Eurobond yields have been on a rising trend YTD. Q1'2020 saw the yield on the 7-year Eurobond issued in 2019 rise by 4.4% to close at 11.0% from 6.6%. The rising yields are an indication that investors are now attaching a higher risk premium on the country due to the anticipation of slower economic growth attributable to the confirmation of the Coronavirus infection within Kenya's borders and locust invasion.	**Positive**	**Neutral**
Security	• Security is expected to be upheld in 2020, given that the political climate in the country has eased. Despite the terror attack experienced in Q1'2019, Kenya was spared from travel advisories, evidence of the international community's confidence in the country's security position	**Positive**	**Positive**

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III. Banking Sector Overview

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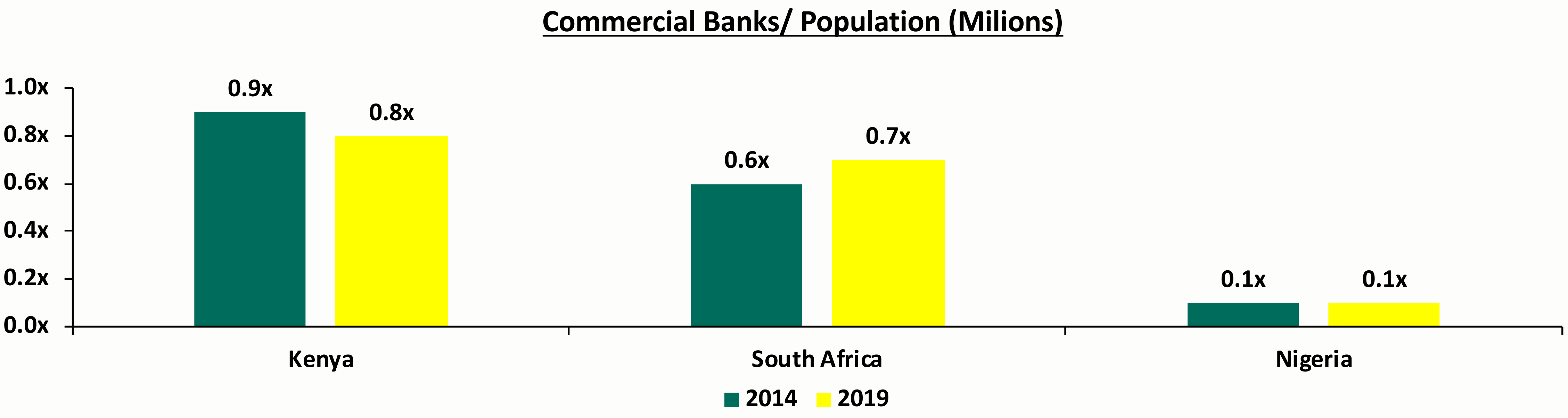
Kenyan Banking Sector Overview

Kenya still remains overbanked as the number of banks remains relatively high compared to the population

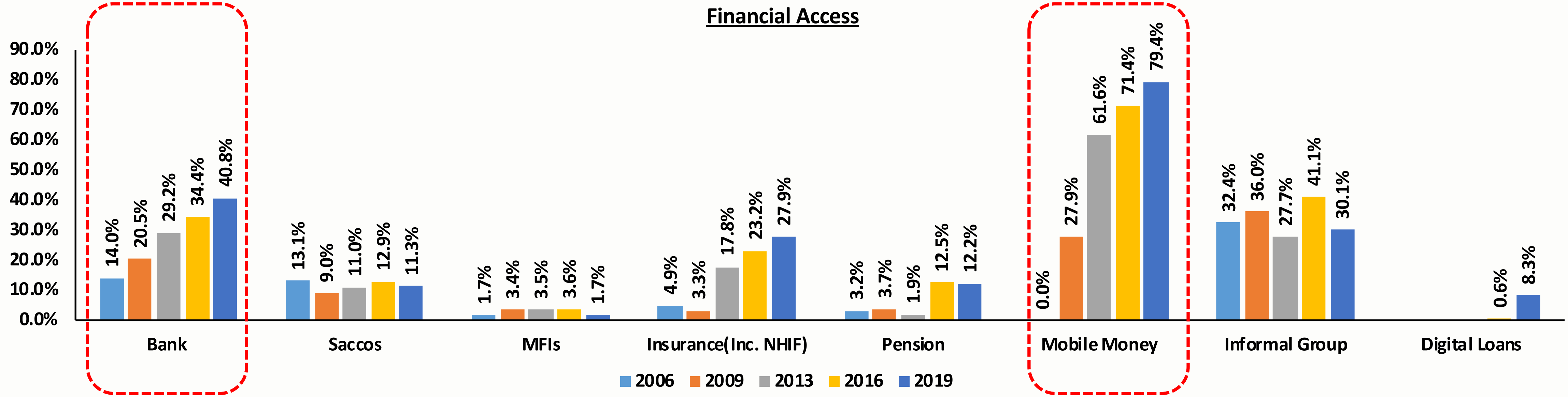


- The number of commercial banks in Kenya has now reduced to 38, compared to 43 banks from 5-years ago. The ratio of the number of banks and Kenya's 47.6 million people now stands at 0.8x, compared with a ratio of 0.9x, 5-years ago. The ratio is improving, however, Kenya still remains overbanked as the number of banks remains relatively high compared to the population.

Kenyan Banking Sector Overview

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

- In Kenya there are a total of 38 commercial banks, 1 mortgage finance company, 13 microfinance banks, 9 representative offices of foreign banks, 74 foreign exchange bureaus, 18 money remittance providers and 3 credit reference bureaus
- Financial inclusion in Kenya has continued to rise, with 82.9% of the adult population able to access formal financial services. This has largely been driven by digitization, with Mobile Financial Services (MFS), transfer and lending, rising to be the preferred method to access financial services in 2019, with 79.4% of the adult population using the channel



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Source: Central Bank of Kenya, FinAccess report

Recent Developments in the Kenyan Banking Sector

The Finance Act 2019 was passed, scrapping off interest rate caps

1. Regulation:

i. **Finance Act 2019 -** During the year, the Finance Act 2019 was passed, which effectively repealed section 33B of the Banking Act, that had previously capped interest rates at a maximum of 4.0% points above the Central Bank Rate (CBR). The removal of interest rate caps is expected to enhance access to credit by the private sector. Banks' performance are expected to improve as they are able price risk better without a rate cap,

ii. **Demonetization-** During the year, the Central Bank of Kenya concluded the withdrawal of the older Kshs. 1,000 banknotes and introduce new notes in an effort to track and curb illicit financial flows. After the demonetization exercise, which had little impact on inflation or the exchange rate, Kshs. 7.4 billion, or 3% of the total value in the circulation of Kshs. 1,000 notes, was rendered worthless. In some cases, this exercise tightened liquidity in the money market thus prompting people to seek alternatives on digital platforms, thus, increasing NFI from fees and commissions.

Recent Developments in the Kenyan Banking Sector

Consolidation continues in the banking sector, with the most recent being that of NIC and CBA to form NCBA

iii. IFRS 9 - With the implementation of IFRS 9, which took effect from 1st January 2018, banks were expected to provide both for the incurred and expected credit losses. The CBK had given commercial banks a one year earnings protection window for the implementation of the IFRS 9 to charge the higher provisions against the retained earnings in the balance sheet and not on the profit and loss account. The banking industry experienced the effects in 2019, recording an increase in NPL Coverage to 58.5% in FY’19 from 54.6% in FY’18, as a result of increased provisioning,

2. Consolidation:

Kenya’s banking sector has witnessed heightened M&A activity over the last 5 years. Consolidation activity remained one of the key highlights witnessed in FY’2019 as players in the sector are either acquired or merge, leading to formation of relatively larger, well capitalized and possibly more stable entities.

Below is a summary of key transactions done over the last five years and their transaction multiples

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Recent Developments in the Kenyan Banking Sector

Consolidation continues in the banking sector, with the most recent being that of NIC and CBA to form NCBA

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs. Bns)	Transaction Stake	Transaction Value	P/Bv Multiple	Date
Co-operative Bank	Jamii Bora Bank	3.4	100.0%	Undisclosed	N/A	Mar-20*
Access Bank PLC (Nigeria)	Transnational Bank PLC.	1.9	100.0%	Undisclosed	N/A	Jan-20*
Commercial International Bank	Mayfair Bank	1.1	Undisclosed	Undisclosed	N/A	Dec-19*
Oiko Credit	Credit Bank	3.0	22.8%	1.0	1.5x	Aug-19
KCB Group	National Bank of Kenya	7.0	100.0%	6.6	0.9x	Sep-19
CBA Group	NIC Group	33.5	53%:47%	23.0	0.7x	Sep-19
CBA Group**	Jamii Bora Bank	3.4	100.0%	1.4	0.4x	Jan-19
AfricInvest Azure	Prime Bank	21.2	24.2%	5.1	1.0x	Jan-19
KCB Group	Imperial Bank	Unknown	Undisclosed	Undisclosed	N/A	Dec-18
SBM Bank Kenya	Chase Bank Ltd	Unknown	75.0%	Undisclosed	N/A	Aug-18
DTBK	Habib Bank Kenya	2.4	100.0%	1.8	0.8x	Mar-17
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	1.6x	Nov-16
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	1.4x	Jun-16
I&M Holdings	Giro Commercial Bank	3.0	100.0%	5.0	1.7x	Jun-16
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	2.3x	Mar-15
Centum	K-Rep Bank	2.1	66.0%	2.5	1.8x	Jul-14
GT Bank	Fina Bank Group	3.9	70.0%	8.6	3.2x	Nov-13
Average			**75.7%**		**1.4x**	

*** Announcement date**

****Deals that were dropped**

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Recent Developments in the Kenyan Banking Sector

CBK and various banks launched their SME-focused lending programs, with the launch of the Stawi facility being the key highlight

3. SME-Focussed Lending:

i. The Central Bank of Kenya (CBK) launched a loan facility dubbed as 'Stawi' targeting Micro Small and Medium Enterprises (MSMEs), enabling businesses to access unsecured loans ranging from Kshs 30,000 to Kshs 250,000 from five commercial banks (NIC Group, KCB Group, Diamond Trust Bank Kenya (DTBK), Co-operative Bank Kenya and Commercial Bank of Africa (CBA)), with a repayment period of between 1– 12 months. Priced at 9.0% p.a, the credit product will help address MSMEs challenges such as access to formal credit because of the informal nature of their businesses and lack of collateral, amid low private sector credit growth rate,

ii. Credit Bank acquired a Kshs 824.0 mn loan from Africa Development Bank for onward lending to SMEs. The loan is to be accessed by companies in the construction, agriculture, renewable energy and manufacturing sector, in a bid to enhance sustainable growth.

iii. The African Guarantee Fund (AGF) set aside USD 170.0 mn (Kshs 17.1 bn) with an aim to back Kenyan Banks to enable them to lend to MSMEs. AGF committed to guarantee half the value of a loan balance to a single MSME borrower or half the value of an outstanding MSME loan portfolio, charging banks a fee ranging between 1.5%- 3.0% for the risk guarantee, and

iv. Additionally, Equity Bank Kenya acquired a syndicated loan worth Kshs 10.0 bn from the International Finance Corporation (IFC) in order to extend loans to MSMEs and climate friendly investors, in a bid to deepen financial inclusion and boost sustainable investments in Kenya

Banking Sector Growth Drivers

Refocus on core operation revenue diversification, and consolidation are among the key growth drivers for banks

1. **Refocus on Core Operations -** With the option of pricing loans as per risk profiles of borrowers, banks will be able to increase interest rates with bias to credit risk rating of borrowers, which will in turn improve their interest income. Going forward, we expect banks to refocus on lending with many banks looking to target select segments such as corporate entities and Small and Medium Enterprises (SMEs). This strategy can be expected to persist post the interest rate cap era,

2. **Revenue Diversification** - Banks have continued to diversify their revenue sources, in a bid to increase profit margins. Banks increased the fees and commissions on loans, and ventured into various NFI growth ventures such as banc assurance, brokerage services, and fleet management. NFI was also earned from transactional income obtained as the number of transactions increased buoyed by increased adoption of alternative channels of transactions,

3. **Expansion and Further Consolidation-** With the Microfinance-Bill 2019 of increasing the minimum on core capital requirements still in its pilot stage more mergers and acquisitions would enable the unprofitable and/or smaller banks to manage the requirement and be able to increase profitability through cost efficiency and deposits growth**.**

Banking Sector Growth Drivers

Alternative channels of transactions and regional expansion remain the key growth drivers for banks

4. **Increased Adoption of Technology -** Banks have been riding on the digital revolution wave to improve their operational efficiency. Increased adoption of alternative channels of transactions such as mobile, internet and agency banking, has led to increased transactions carried out via alternative channels and out of bank branches, which have been reduced to handling high value transactions and other services such as advisory. Thus banks reduced front-office operations, thereby cutting the number of staff required and by extension, reducing operating expenses and hence, improving operational efficiency,

5. **Regional Expansion -** Kenyan banks continued to pursue their inorganic growth strategies beyond Kenya, as they seek to increase their profit margins and compete better with a key example being Equity Group Holdings, who announced being in talks to acquire a majority stake (66.5%) in Banque Commercial du Congo (BCDC, subject to shareholder and regulatory approvals) in a deal that will see them pay Kshs 10.7 bn. The bank also entered into a binding term sheet with Atlas Mara Limited to acquire certain banking assets in 4 countries in exchange for shares in Equity Group. Atlas Mara is exiting four markets namely Rwanda, Zambia ,Tanzania and Mozambique. The bank's plan is to enter new markets through a combination of acquisitions and setting up of fresh operations such as in Ethiopia,

Regulation and Revenue Diversification to Drive Growth

Focus Area	Summary	Effect on Banking Sector
Regulation	• **Finance Act 2019:** The act was passed which effectively repealed Section 33B of the Banking Act that previously capped interest rate caps at a maximum of 4.0% above the Central Bank Rate	• Increased lending because banks are able to price risk better without a rate cap • Net Interest Margins expected to shift upwards as banks can now set their own interest rates • Overall performance of the sector will improve owing to better net interest margins
Diversification	• **Revenue Diversification:** Banks continued their focus on diversifying their revenue sources, targeting transactional fee income, as well as increased income from non-banking subsidiaries	• Consistent relatively strong profitability growth, which has alleviated the effects of a relatively slow funded income growth

The Banking sector maintained its growth trajectory largely aided by recovery in funded income as well as a relatively stronger growth in NFI. Increased usage of alternative channels improves operational efficiency as well as expanding Non-Funded Income.

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Asset Quality Remains a Major Concern in the Banking Sector

Focus Area	Summary	Effect on Banking Sector
Consolidation	• **Increase in Mergers & Acquisitions:** With increased competition amongst players in the banking sector, coupled with tough operating environment, has led to several consolidation activity has happened.	• Consolidation in the sector have resulted in (i) aiding in successful remediation of collapsed banks, (ii) leaving fewer but well capitalized players able to catalyze economic growth, thus creating a more stable banking sector
Asset Quality	• **High Non-Performing Loans:** the Gross NPL ratio stood at 10.5%, from 9.9% recorded in FY'2018 and much higher than the 5-year average of 8.1%. This raises concerns around asset quality in the sector	• The increased NPLs and adoption of IFRS 9 has forced banks to adopt a more stringent risk assessment framework, to effectively reduce financial impairments and consequently the provisioning requirements required under the new reporting standard, leading to reduced credit extension

Deteriorating asset quality remains a concern, which has seen banks reduce lending to the riskier private sector and instead continue channeling funds to government securities

IV. Listed Banking Sector Metrics

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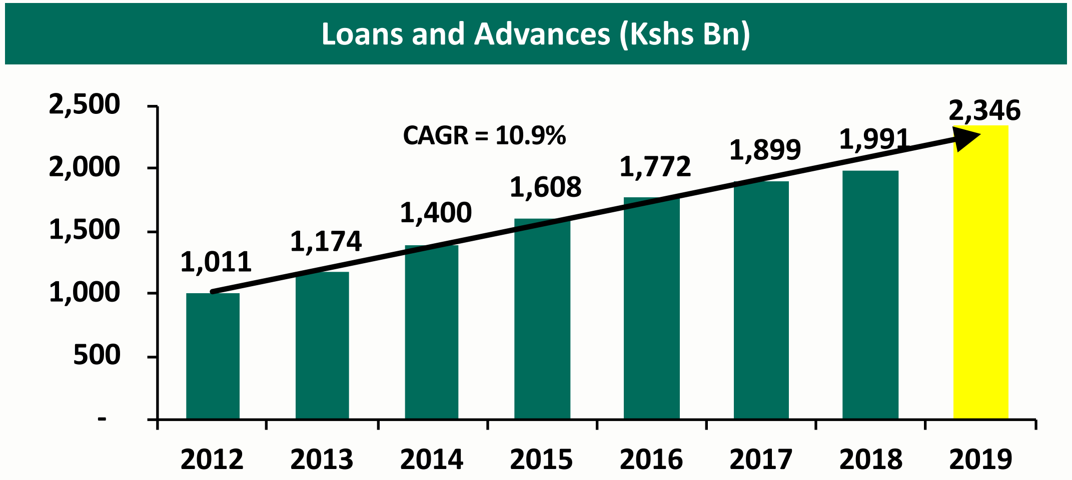
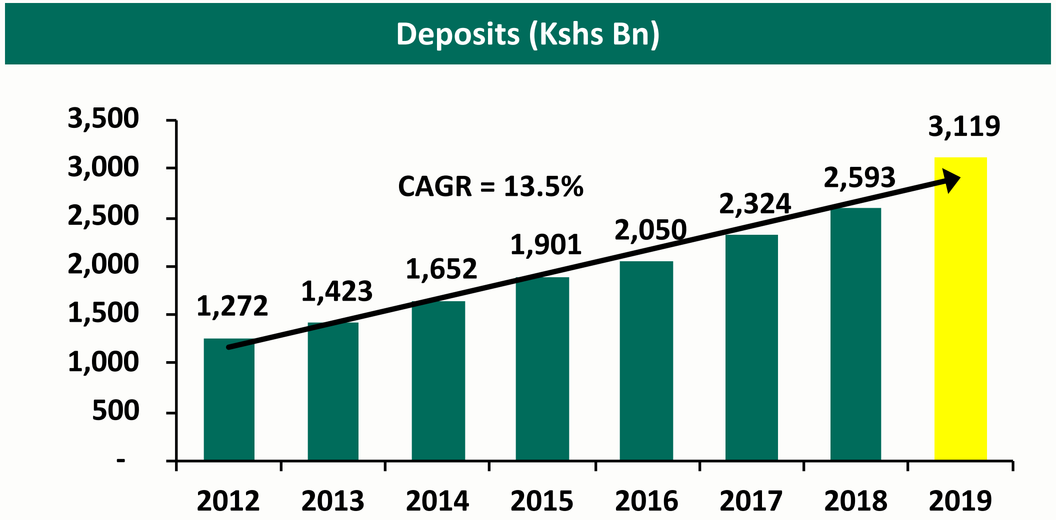
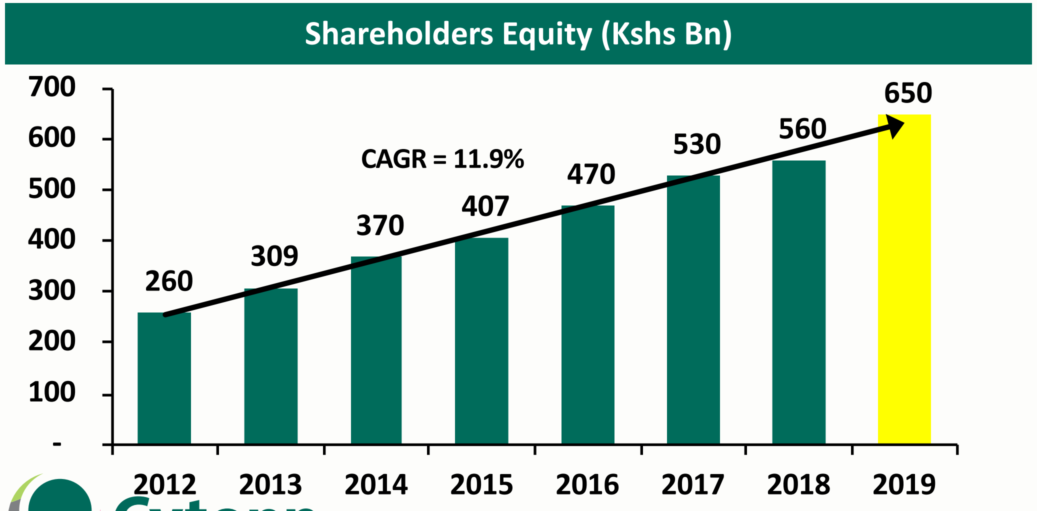
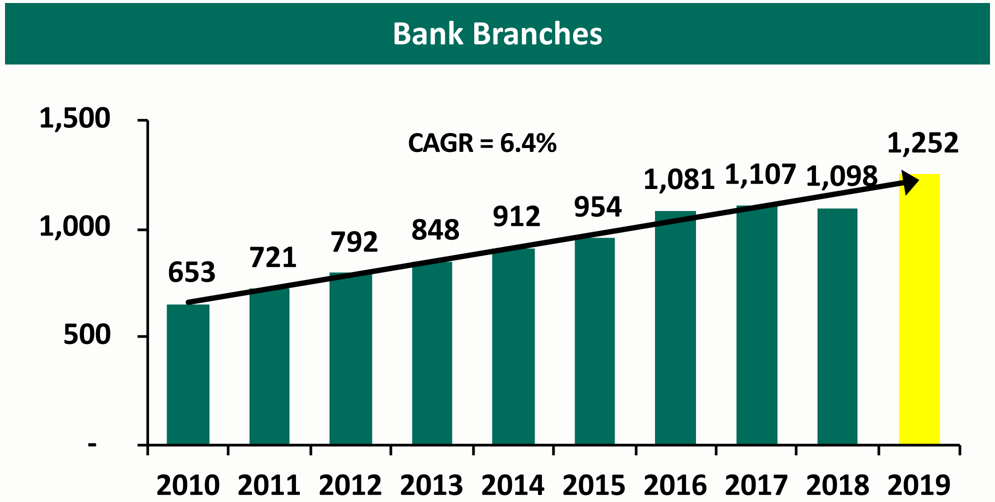
Listed Banking Sector Metrics

Deposit growth has remained strong, faster than the growth in loans and advances





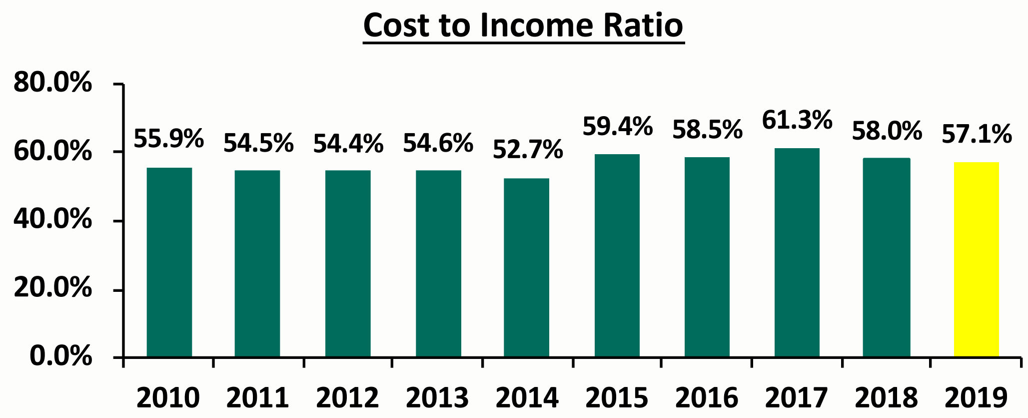




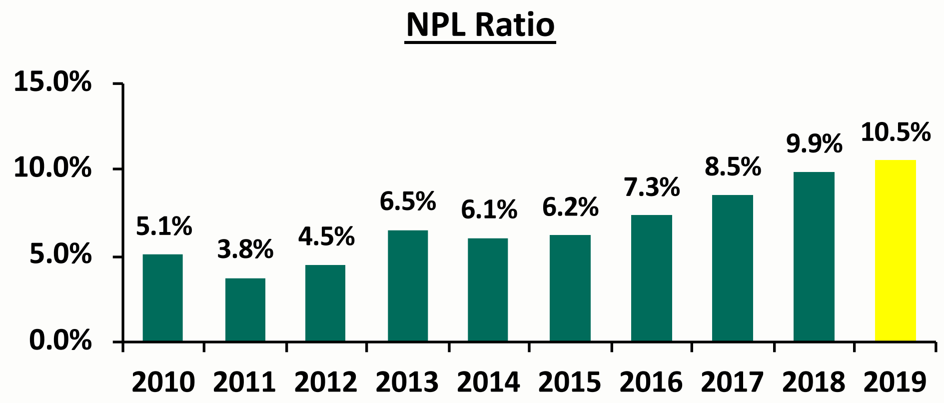
Listed Banking Sector Metrics

The repeal of the rate capping law is expected to increase lending, with banks continuing to focus on improving efficiency, growing NFI and containing asset quality deterioration

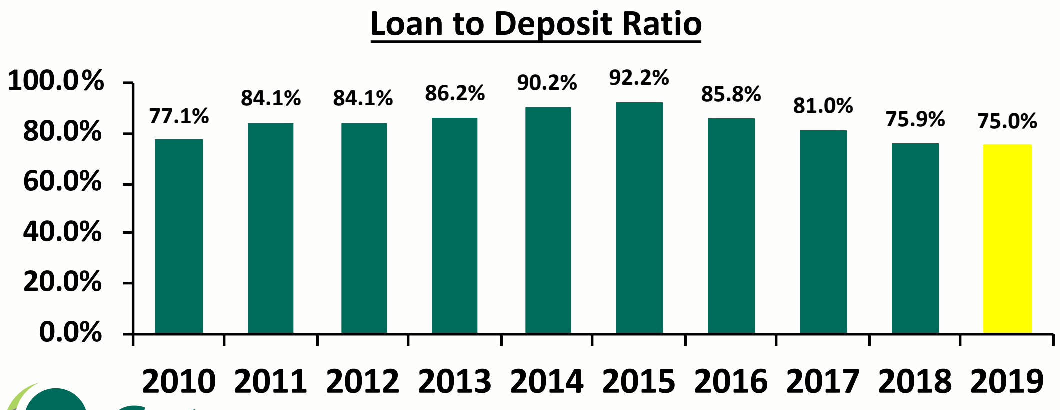
Cost to Income Ratio



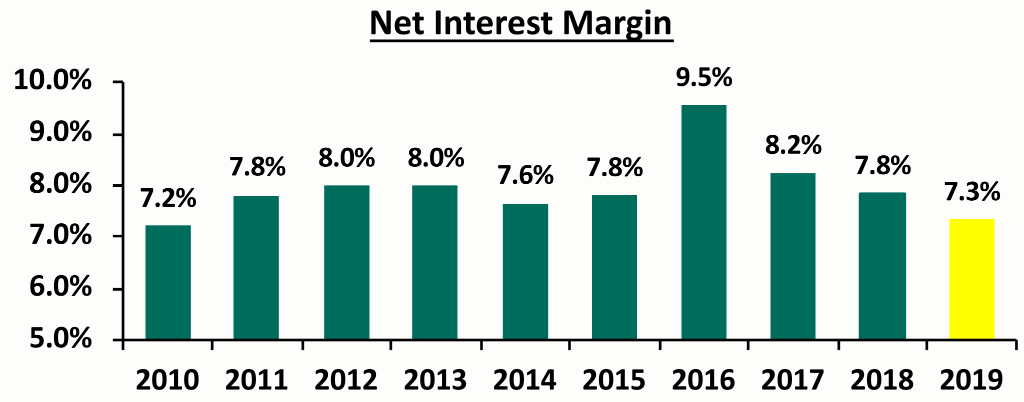
NPL Ratio



Loan to Deposit Ratio



Net Interest Margin



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Listed Banking Earnings and Growth Metrics

Kenya’s listed banking sector FY’2019 core EPS increased by 8.9%, slower compared to a growth of 13.8% in FY’2018

Bank	Core EPS Growth	Net Interest Margin	NFI to Total Operating Income	Deposit Growth	Growth In Govt Securities	Loan Growth	LDR	Cost to Income	Return on Average Equity
I&M Holdings	26.6%	5.9%	34.8%	7.8%	3.4%	5.2%	76.3%	42.4%	19.5%
Absa Bank	21.2%	7.7%	31.4%	14.6%	32.3%	9.9%	82.0%	63.6%	16.7%
Equity Bank	13.8%	8.5%	40.6%	14.2%	6.2%	23.3%	75.9%	58.5%	22.0%
Coop Bank	12.4%	8.5%	35.4%	8.7%	46.8%	8.7%	80.1%	57.4%	19.2%
KCB Group	4.9%	8.2%	33.4%	27.7%	41.0%	17.4%	78.0%	56.2%	20.7%
SCBK	1.7%	7.4%	32.2%	1.8%	0.9%	8.5%	56.3%	57.6%	17.5%
Stanbic Bank	1.6%	5.2%	46.1%	2.4%	(12.7%)	9.3%	85.1%	56.2%	13.6%
DTBK	1.6%	5.6%	23.6%	(0.9%)	12.9%	3.1%	71.1%	54.0%	12.9%
NCBA Group	(12.4%)	3.3%	60.4%	10.9%	11.8%	4.1%	65.9%	60.5%	10.6%
HF Group	N/A	4.3%	41.6%	7.7%	43.3%	(11.3%)	103.1%	104.2%	(1.1%)
FY'2019 Weighted Average	**8.9%**	**7.3%**	**37.4%**	**12.7%**	**19.4%**	**12.8%**	**75.0%**	**57.0%**	**18.4%**
FY'2018 Weighted Average	**13.8%**	**7.9%**	**33.3%**	**10.3%**	**9.3%**	**4.3%**	**75.3%**	**58.0%**	**18.9%**

**Loans to Loanable funds used owing to nature of the business*
*** HF Group had the highest EPS growth but this was a reduction in loss per share as they are not profitable yet*
****The weighted average is based on market capitalization as at 09th April 2020*

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Takeout from Key Operating Metrics

Listed banks continued to record a relatively strong performance with the average increase in core EPS coming in at 8.9%

1. The above ten listed Kenyan banks recorded an 8.9% average increase in core Earnings per Share (EPS), lower than the 13.8% recorded in FY'2018 for all listed banks. The Return on Average Equity (RoAE) consequently declined to 18.4%, from 19.0% recorded in FY'2018
2. The banks recorded stronger deposit growth, which came in at 12.7%, faster than the 10.3% growth recorded in the sector in FY'2018. Despite the stronger deposit growth, Interest expenses increased at a slower pace of 3.4%, compared to 10.6% in FY'2018, indicating the banks have been able to mobilize relatively cheaper deposits, which saw the cost of funds decline to 3.7 from 4.1 in FY'2018
3. Average loan growth came in at 12.8%, which was faster than the 4.3% recorded in FY'2018 with the growth in loans being accelerated towards the tail end of FY'2019 following the repeal of interest rate cap in November 2019. Government securities, on the other hand, recorded a growth of 19.4% y/y, attributable to banks' continued preference towards investing in government securities, which offered better risk-adjusted returns during the interest rate cap era,

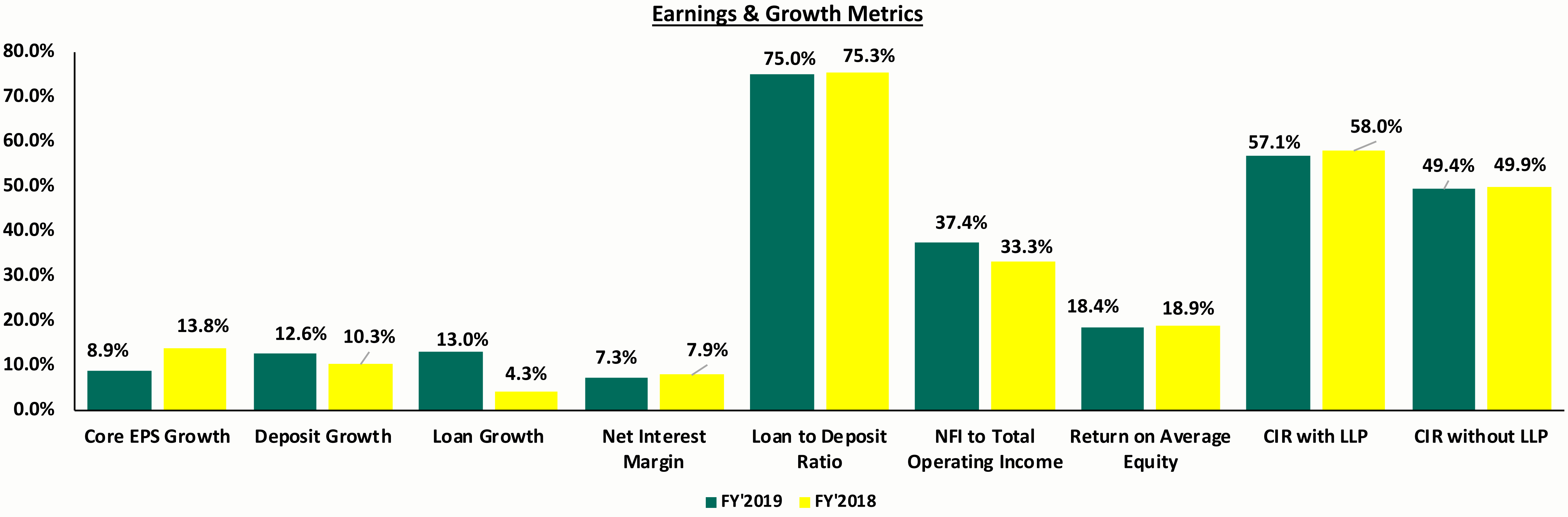
Takeout from Key Operating Metrics

Listed banks continued to record an increase in Non Funded Income coming in at 17.4% for FY'2019

4. Listed Banks recorded a slower 3.2% growth in interest income compared to the 6.5% recorded in FY'2018. This may be attributable to the lower yields on interest-earning assets which declined to 9.9% from 10.7% in FY'2018. The lower yields on interest-earning assets are attributable to a decline in lending rates which were pegged to the Central Bank Rate (CBR). In FY'2019, the CBR was lowered by 50 bps from the 9.0% set in July 2018 to 8.5%. Consequently, the Net Interest Margin (NIM) in the banking sector as at FY'2019, stood at 7.3%, a decline from the 7.9% recorded in FY'2018, mainly due to the faster growth in average interest-earning assets which grew by 5.5% in FY'2019 outpacing the 3.4% growth in Net Interest Income, and,
5. Non-Funded Income grew by 17.4% y/y, faster than the 3.8% recorded in the sector in FY'2018. The growth in NFI was boosted by the total fee and commission income which improved by 18.4%, compared to the (1.0%) growth recorded in the sector FY'2018. We believe the growth in total fees was due to a re-correction from the decline in 2018 which was a one-off adjustment as a result of the implementation of the effective interest rate which required banks to amortize fees and commissions on loans over the tenor of the loans.

Listed Banks Earnings and Growth Metrics Cont…

Listed banks witnessed an improvement in operational efficiency, an improvement in total operating income, and a higher NFI to Total Operating Income ratio as compared to a similar period of review in 2018



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Listed Banks Operating Metrics

Non Funded Income currently contributes 37.4% of banks' total operating income, up from 33.3% in FY'2018, owing to the recovery in NFI after a one-off adjustment in 2018 due to the implementation of Effective Interest Rate (EIR)

Bank	Deposit/Branch (bn)	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non Funded Income/Revenue
NCBA Group	4.6	12.6%	55.9%	12.3%	60.4%
Stanbic Bank	8.6	9.6%	57.1%	13.2%	46.1%
HF Group	1.8	27.7%	47.8%	16.8%	41.6%
Equity Bank	1.6	9.5%	47.5%	15.6%	40.6%
Coop Bank	2.1	11.2%	51.8%	16.9%	35.4%
I&M Holdings	3.4	11.3%	59.1%	17.0%	34.8%
KCB Group	2.0	11.1%	59.5%	13.8%	33.4%
SCBK	6.3	13.9%	78.7%	15.0%	32.2%
Absa Bank	2.7	6.6%	77.0%	11.9%	31.4%
DTBK	2.0	7.6%	42.9%	15.0%	23.6%
Weighted Average FY'2019*	**3.2**	**10.5%**	**58.5%**	**14.7%**	**37.4%**
Weighted Average FY'2018	**3.1**	**9.7%**	**56.9%**	**15.1%**	**33.3%**

**Market cap weighted average as at 09th April 2020*

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Listed Banks Trading Metrics

The listed banking sector has continued to trade at cheaper prices, as it is currently trading at an average P/TBv of 1.0x and average P/E of 5.6x

Bank	No. of shares (bn)	Market Cap (bn)	P/E	Price*	P/TBV
HF Group	0.4	1.6	2.6x	4.2	0.2x
NCBA Group	1.5	42.4	6.0x	28.3	0.7x
DTBK	0.3	24.5	3.4x	87.8	0.4x
Coop Bank	5.9	75.7	5.3x	12.9	1.0x
I&M Holdings	0.8	41.3	4.0x	50.0	0.8x
KCB Group	3.2	111.2	4.4x	34.6	0.9x
Stanbic Bank	0.4	38.0	5.9x	96.0	1.0x
Absa Bank	5.4	53.8	7.2x	9.9	1.2x
SCBK	0.3	63.5	7.7x	185.0	1.4x
Equity Bank	3.8	128.3	5.7x	34.0	1.2x
Weighted Average FY'2019			5.6x		1.0x

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

**Prices as at 09th April 2020*

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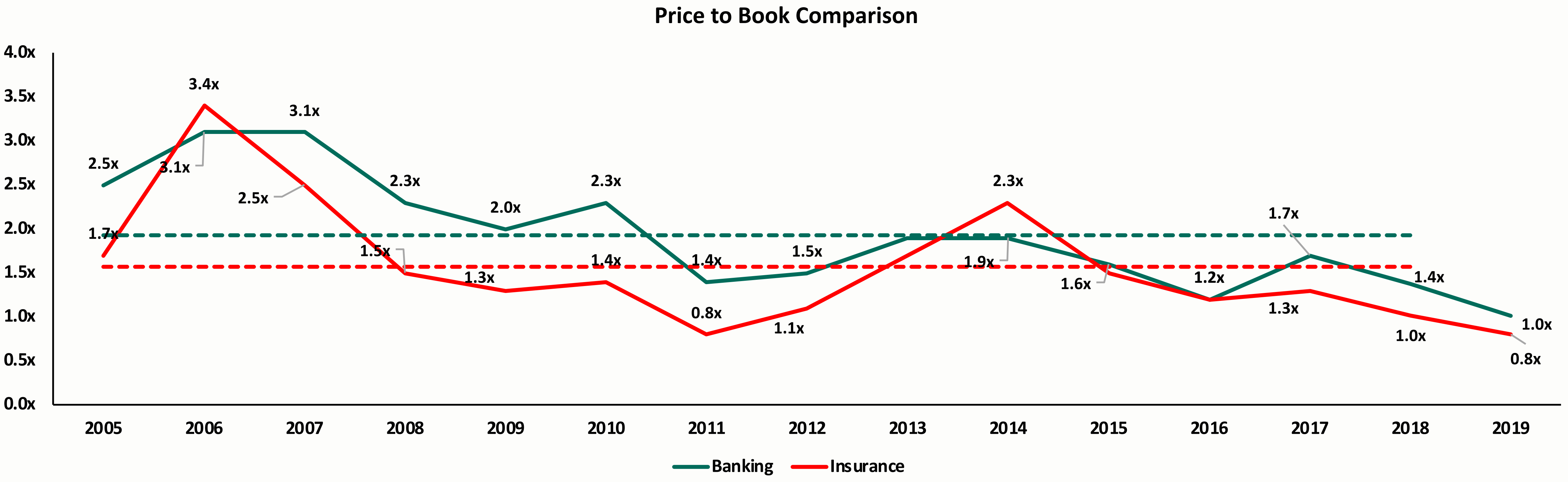
Listed Banks & Insurance Trading Metrics

Listed banks trade at an average P/B of 1.0x, higher than the insurance sector, which is priced at 0.8x. Both sectors are trading below their 14-year averages of 1.9x and 1.6x, respectively

15 year Price to Book Value: Banking and Insurance



On a price to book valuation, listed banks are currently priced at a PBV of 1.0x, higher than listed insurance companies at 0.8x, with both lower than their historical averages of 1.9x for the banking sector and 1.6x for the insurance sector

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Summary of the FY'2019 Earnings

Listed banks continued to record a relatively strong performance, aided by Non-Funded Income expansion as well as improvements in operational efficiency

1. The sector continued to record a positive performance, recording a market cap-weighted increase of 8.9% in core earnings per share in FY'2019, with non-funded revenue expansion and cost rationalization strategies taking effect. Operational efficiency has continued to improve, as shown by the improvement in the cost to income without LLP ratio to 57.0%, from 58.0% in FY'2018,
2. The level of NPLs remains a concern within the banking sector, with the weighted average gross Non-Performing Loans (NPL) ratio for the listed banks rising to 10.5%, above the 5 year average of 8.2%, with the sectors touted as the main contributors being real estate, manufacturing and retail. If the asset deterioration trend persists, this will likely impact bank's bottom line due to the associated impairment charges, especially after the adoption of the new IFRS 9 standard, and,
3. The sector continued to record a relatively strong balance sheet growth, as deposits grew by 12.7%, slower than loans which grew by 12.8%. Loan growth was faster than the 4.3% y/y growth recorded in FY'2018, with the growth in loans being accelerated towards the tail end of FY'2019 following the repeal of interest rate cap in November 2019.

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V. Banks Valuation Reports

Ranking by Franchise Value

I&M Holdings emerged top in the franchise ranking due to high efficiency levels as evidenced by a low Cost to Income ratio which came in at 42.4% vs an industry average of 57.0%

Rank	Bank	LDR	CIR	ROACE	NIM	PEG ratio	PTBV	Deposits / Branch	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non Interest Income/ Revenue	Camel Rating	Total
1	I&M Holdings	5	1	3	6	3	4	4	7	4	1	6	6	50
2	KCB Group	4	4	2	3	2	5	8	5	3	7	7	2	52
3	Coop Bank	3	5	4	2	5	6	6	6	7	2	5	3	54
4	Equity Bank	6	7	1	1	1	8	10	3	9	4	4	4	58
5	Stanbic Bank	1	3	7	8	8	7	1	4	5	8	2	7	61
6	Absa Bank	2	9	6	4	9	9	5	1	2	10	9	1	67
7	DTBK	7	2	8	7	4	2	7	2	10	6	10	5	70
8	SCBK	10	6	5	5	10	10	2	9	1	5	8	9	80
9	NCBA Group	9	8	9	10	7	3	3	8	6	9	1	8	81
10	HF Group	8	10	10	9	6	1	9	10	8	3	3	10	87

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Valuation Summary of Listed Banks

Diamond Trust Bank presents the highest upside with an expected total return of 113.2%

(all values in Kshs)

Bank	Current Price	Target Price	Upside/(Downside)	Dividend Yield	Total Potential Return
DTBK	85.5	179.7	110.1%	3.0%	113.2%
Equity Bank	32.8	55.3	68.6%	7.6%	76.3%
KCB Group	34.5	55.8	61.7%	10.1%	71.9%
Coop Bank	12.5	18.2	46.1%	8.0%	54.3%
I&M Holdings	51.0	73.6	44.2%	5.0%	49.2%
NCBA Group Plc	28.0	39.4	40.9%	6.3%	47.2%
Absa Bank	9.9	12.6	27.6%	11.2%	38.7%
SCBK	182.3	223.6	22.7%	11.0%	33.6%
Stanbic Holdings	93.8	109.8	17.2%	7.5%	24.7%
HF Group	4.2	4.3	2.5%	0.0%	2.5%

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Cytonn Banking Report - Comprehensive Ranking

KCB emerged top of the ranking in terms of comprehensive ranking

(all values in Kshs unless stated otherwise)

Bank	Franchise Value Score	Intrinsic Value Score	Weighted Score	FY'2019 Rank
KCB Group Plc	52	3	22.6	1
I&M Holdings	50	5	23.0	2
Co-operative Bank of Kenya Ltd	54	4	24.0	3
Equity Group Holdings Ltd	58	2	24.4	4
DTBK	70	1	28.6	5
Stanbic Bank/Holdings	61	9	29.8	6
ABSA	67	7	31.0	7
NCBA Group Plc	81	6	36.0	8
SCBK	80	8	36.8	9
HF Group Plc	87	10	40.8	10

VI. Appendix

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A. Tier I Banks

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I. Equity Group Holdings

Equity Group Summary of Performance – FY'2019

- Profit before tax increased by 10.6% to Kshs 31.5 bn, up from Kshs 28.5 bn in FY'2018. Profit after tax recorded a 13.8% growth to Kshs 22.6 bn, from Kshs 19.8 bn, with the difference in growth attributable to the decrease in the effective tax rate to 28.3% from 30.4% in FY'2018
- Total operating income rose by 12.6% to Kshs 75.8 bn, from Kshs 67.3 bn in FY'2018. This was driven by an 8.6% increase in Net Interest Income (NII) to Kshs 45.0 bn from Kshs 41.4 bn in FY'2018, coupled with a 19.0% rise in Non-Funded Income (NFI) to Kshs 30.8 bn, from Kshs 25.9 bn in FY'2018,
- Total operating expenses rose by 14.1% to Kshs 44.3 bn, from Kshs 38.8 bn in FY'2018, largely driven by a 42.8% increase in Loan Loss Provisions (LLP) to Kshs 5.3 bn, from Kshs 3.7 bn in FY'2018, coupled with a 11.8% rise in staff costs to Kshs 12.8 bn from Kshs 11.5 bn in FY'2018, and a 10.7% growth in other operating expenses to Kshs 26.2 bn, from Kshs 23.7 bn in FY'2018,
- The balance sheet recorded an expansion as total assets increased by 17.5% to Kshs 673.7 bn, from Kshs 573.4 bn in FY'2018,
- The bank's asset quality deteriorated, with the NPL ratio deteriorating to 9.5% in FY'2019 from 9.2% in FY'2018 but still below the industry average of 12.1%. The main sectors that contributed to the slight deterioration in asset quality are SMEs and Large Enterprise sector's contributing 11.3% and 9.4%, respectively, to total NPL.
- Going forward, we expect the bank's growth to be driven by:

i. **Increased channeled diversification**, which is likely to help the bank to continue improving its operational efficiency. The benefits of this are already being felt, as the bank aligned its staff head count to its operational needs. Continued emphasis on these alternative channels of transactions, as the bank rides on the digital revolution wave, will likely lead to further cost to income ratio improvements by cost rationalization and NFI expansion.

Financial Statements Extracts

Equity Group's PAT is expected to grow at a 5-year CAGR of 11.3%

Income Statement	2018	2019	2020e	2021e
Net Interest Income	41.4	45.0	49.1	53.9
Non Funded Income	25.9	30.8	32.9	36.3
Total Operating Income	67.3	75.8	82.0	90.1
Loan Loss Provision	(3.7)	(5.3)	(6.2)	(6.6)
Other Operating Expenses	(35.1)	(39.0)	(41.1)	(46.1)
Total Operating Expenses	**(38.8)**	**(44.3)**	**(47.4)**	**(52.7)**
Profit Before Tax	28.5	31.5	34.6	37.4
% PAT Change YoY	**4.8%**	**13.8%**	**7.4%**	**8.0%**
EPS	5.3	6.0	6.4	6.9
DPS	2.0	2.5	2.5	2.5
Cost to Income	57.7%	58.5%	57.8%	58.5%
NIM	**8.5%**	**8.5%**	**8.3%**	**8.3%**
ROaE	21.2%	22.0%	17.7%	15.3%
ROaA	3.6%	3.6%	3.4%	3.3%
Balance Sheet	**2018**	**2019**	**2020e**	**2021e**
Net Loans and Advances	297.2	366.4	366.5	410.4
Government Securities	130.4	138.6	162.9	174.1
Other Assets	145.7	168.7	218.5	240.3
Total Assets	**573.4**	**673.7**	**747.9**	**824.9**
Customer Deposits	422.8	482.8	502.0	562.2
Other Liabilities	55.7	79.2	82.0	82.1
Total Liabilities	**478.4**	**561.9**	**584.0**	**644.3**
Shareholders Equity	**94.1**	**110.7**	**162.8**	**179.5**
Number of Shares	**3.8**	**3.8**	**3.8**	**3.8**
Book value Per share	24.9	29.3	43.1	47.6
% Change in BPS YoY	**1.0%**	**17.7%**	**47.0%**	**10.3%**

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Valuation Summary

Equity Group is undervalued with a total potential return of 76.3%

Cost of Equity Assumptions:	17-April-20
Risk free rate *	12.3%
Beta	0.9
Country Risk Premium	6.0%
Cost of Equity	18.1%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.7%
Return on Average Equity 2024	16.5%
Terminal Price to Book value per share	1.8x
Shareholder Equity (Kshs)- FY24e	247.3
Terminal Value (Kshs) - (Year 2024)	455.7

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intergrated DDM	70.2	40.0%	28.1
Residual Income	57.8	35.0%	20.2
PBV Multiple	26.9	20.0%	5.4
PE Multiple	33.0	5.0%	1.7
Fair Value			**55.3**
Current Price			**32.8**
Upside/(Downside)			68.6%
Dividend Yield			7.6%
Total Potential Return			**76.3%**

Cytonn

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

II. KCB Group

KCB Group Summary of Performance – FY’2019

- Profit before tax increased by 9.0% to Kshs 36.9 bn, up from Kshs 33.9 bn in FY’2018. Profit after tax grew by 4.9% to Kshs 25.2 bn in FY’2019, from Kshs 24.0 bn in FY’2018 with the effective tax rate rising to 31.8% from 29.1% in FY’2018,
- Total operating income rose by 17.4% to Kshs 84.3 bn, from Kshs 71.8 bn in FY’2018. This was driven by a 22.6% rise in Non-Funded Income (NFI) to Kshs 28.2 bn, from Kshs 23.0 bn in FY’2018, coupled with a 15.0% rise in Net Interest Income (NII) to Kshs 56.1 bn, from Kshs 48.8 bn in FY’2018,
- Total operating expenses grew by 24.9% to Kshs 47.4 bn, from Kshs 37.9 bn, largely driven by a 201.9% rise in Loan Loss Provisions (LLP) to Kshs 8.9 bn in FY’2019, from Kshs 2.9 bn in FY’2018, coupled with a 14.4% rise in staff costs to Kshs 19.5 bn in FY’2019, from Kshs 17.0 bn in FY’2018,
- The balance sheet recorded an expansion as total assets grew by 25.8% to Kshs 898.6 bn, from Kshs 714.3 bn in FY’2018,
- The bank’s asset quality deteriorated, with the NPL ratio increasing to 11.1%, from 6.9% in FY’2018, due to the faster growth in Gross Non-Performing Loans (NPLs), which outpaced the growth in loans. This was after the acquisition of NBK, which saw the non-performing loans portfolio of the Group rise by 93.9% to Kshs 63.4 bn.
- Going forward, we expect the bank’s growth to be driven by:

i. **Increased channeled diversification**, which is likely to help the bank to continue improving its operational efficiency. The benefits of this are already being felt, as the bank aligned its staff head count to its operational needs. Continued emphasis on these alternative channels of transactions, as the bank rides on the digital revolution wave, will likely lead to further cost to income ratio improvements by cost rationalization and NFI expansion.

Financial Statements Extracts

KCB Group's PAT is expected to grow at a 5-year CAGR of 10.0%

Income Statement	2018	2019	2020F	2021F
Net Interest Income	48.8	56.1	64.1	70.4
Non Funded Income	23.0	28.2	27.2	28.2
Total Operating Income	**71.8**	**84.3**	**91.4**	**98.7**
Loan Loss Provision	2.9	8.9	11.1	10.6
Other Operating Expenses	35.0	38.5	44.1	46.7
Total Operating Expenses	**37.9**	**47.4**	**55.2**	**57.3**
Profit Before Tax	33.9	36.9	36.2	41.4
% PAT Change YoY	**21.8%**	**4.9%**	**0.7%**	**14.4%**
EPS	7.9	7.8	7.9	9.0
DPS	3.0	3.5	3.5	4.0
Cost to Income	52.8%	56.2%	60.4%	58.0%
NIM	**8.2%**	**8.2%**	**8.3%**	**8.5%**
ROE	21.9%	20.7%	18.5%	19.1%
ROA	3.5%	3.1%	2.8%	3.0%
Balance Sheet	**2018**	**2019f**	**2020f**	**2021f**
Net Loans and Advances	455.9	535.4	571.6	607.3
Government Securities	120.1	169.2	178.2	186.9
Other Assets	138.4	194.0	176.8	184.8
Total Assets	**714.3**	**898.6**	**926.5**	**978.9**
Customer Deposits	537.5	686.6	700.0	735.0
Other Liabilities	63.2	82.2	82.7	84.0
Total Liabilities	**600.7**	**768.8**	**782.7**	**819.0**
Shareholders Equity	**113.7**	**129.7**	**143.8**	**160.0**
Number of Shares	**3.0**	**3.2**	**3.2**	**3.2**
Book value Per share	37.6	40.4	44.8	49.8
% Change in BPS YoY	**7.3%**	**7.5%**	**10.9%**	**11.2%**

Cytonn

Valuation Summary

KCB Group is undervalued with a total potential return of 71.9%

Cost of Equity Assumptions:	17-April-20
Risk free rate *	12.3%
Beta	0.9
Country Risk Premium	6.0%
Cost of Equity	17.7%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.3%
Return on Average Equity 2024	18.8%
Terminal Price to Book value per share	1.2x
Shareholder Equity (Kshs) - FY24e	228.8
Terminal Value (Kshs) - (Year 2024)	289.4

Valuation Summary	Implied Price	Weighting	Weighted Value
Residual Income	58.1	35%	20.3
PBV Multiple	39.5	20%	7.9
PE Multiple	44.9	5%	2.2
DDM Integrated	63.6	40%	25.3
Target Price			**55.8**
Current Price			**34.5**
Upside/(Downside)			61.7%
Dividend Yield			10.1%
Total Return			**71.9%**

Cytonn

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

III. Co-operative Bank

Cytonn

Co-operative Bank Summary of Performance – FY’2019

- Profit before tax increased by 14.0% to Kshs 20.7 bn, up from Kshs 18.2 bn in FY’2018. Profit after tax grew by 12.4% to Kshs 14.3 bn in FY’2019, from Kshs 12.7 bn in FY’2018 with the effective tax rate declining to 31.6% from 32.7% in FY’2018,
- Total operating income increased by 10.9% to Kshs 48.5 bn in FY’2019, from Kshs 43.7 in FY’2018. This was due to a 33.1% increase in Non-Funded Income (NFI) to Kshs 17.2 bn from Kshs 12.9 bn in FY’2018. The growth was also supported by the 1.7% marginal growth in Net Interest Income (NII) to Kshs 31.3 bn from Kshs 30.8 bn in FY’2018,
- Total operating expenses rose by 8.2% to Kshs 27.8 bn in FY’2019, from Kshs 25.7 bn in FY’2018, largely driven by the 37.9% rise in Loan Loss Provisions (LLP) to Kshs 2.5 bn from Kshs 1.8 bn in FY’2018, coupled with staff costs increase of 8.1% to Kshs 12.4 bn in FY’2019 from Kshs 11.5 bn in FY’2018,
- The balance sheet recorded an expansion as total assets grew by 10.5% to Kshs 457.0 bn, from Kshs 413.4 bn in FY’2018,
- The bank’s asset quality improved, with the NPL ratio reducing marginally to 11.2% in FY’2019, from 11.3% in FY’2018 owing to faster growth in gross loans by 9.1% outpacing the 7.5% growth in gross non-performing loans, which is attributable to the implementation of credit management strategies implemented since the beginning of the year.
- Going forward, we expect the bank’s growth to be driven by:

i. **Business Model Restructuring,** the banks’ has continued implementation of “Soaring Eagle” transformation initiatives is expected to drive growth and increase efficiency. The initiatives are set on the following eight key pillars; branch transformation, MSME transformation, sales force effectiveness, shared services and digitization, NPL management and credit processes, cost management, data analytics, and staff productivity. We expect the initiatives to culminate into improved revenue levels.

Cytonn

Financial Statements Extracts

Co-operative Bank's PAT is expected to grow at a 5-year CAGR of 7.4%

Income Statement	2018	2019	2020F	2021F
Net Interest Income	30.8	31.3	30.1	31.7
Non Funded Income	12.9	17.2	15.7	19.1
Total Operating Income	**43.7**	**48.5**	**45.8**	**50.8**
Loan Loss Provision	(1.8)	(2.5)	(2.5)	(2.7)
Other Operating Expenses	(23.9)	(25.3)	(24.5)	(26.5)
Total Operating Expenses	**(25.7)**	**(27.8)**	**(27.0)**	**(29.2)**
Profit Before Tax	18.20	20.7	18.9	21.7
% PAT Change YoY	**11.6%**	**12.4%**	**-7.7%**	**15.0%**
EPS	1.9	2.4	2.3	2.6
DPS	1.0	1.0	1.0	1.0
Cost to Income	58.8%	57.4%	58.9%	57.4%
ROE	18.3%	19.2%	14.1%	13.4%
ROA	3.2%	3.3%	2.7%	2.9%
Balance Sheet				
Net Loans and Advances	245.4	266.7	290.3	306.5
Government Securities	80.3	117.8	93.3	98.6
Other Assets	87.7	72.5	122.7	131.8
Total Assets	413.4	457.0	506.3	536.8
Customer Deposits	306.1	332.8	352.8	374.0
Other Liabilities	36.1	43.3	43.4	43.4
Total Liabilities	342.2	376.2	396.2	417.4
Shareholders Equity	69.9	79.3	108.6	117.9
Number of Shares	6.9	5.9	5.9	5.9
Book value Per share	10.2	13.5	18.5	20.1
% Change in BPS YoY	**-14.2%**	**32.9%**	**36.9%**	**8.6%**

Cytonn

Valuation Summary

Co-operative Bank is undervalued with a total potential return of 54.3%

Cost of Equity Assumptions:	17-April-20
Risk free rate *	12.3%
Beta	1.0
Country Risk Premium	6.0%
Cost of Equity	18.3%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.3%
Return on Average Equity 2024	13.6%
Terminal Price to Book value per share	1.2x
Shareholder Equity (Kshs) - FY24e	157.9
Terminal Value (Kshs)- (Year 2024)	199.0

Valuation Summary	Implied Price	Weighting	Weighted Value
Residual Income	14.6	35%	5.1
PBV Multiple	13.3	20%	2.7
PE Multiple	13.6	5%	0.7
DDM Integrated	24.4	40%	9.8
Target Price			**18.2**
Current Price			**12.5**
Upside/(Downside)			46.3%
Dividend Yield			8.0%
Total Return			**54.3%**

Cytonn

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

IV. NCBA Bank

Cytonn

NCBA Bank Summary of Performance – FY'2019

- Profit before tax declined by 7.8% to Kshs 11.3 bn from Kshs 12.3 bn in FY'2018. Profit after tax before exceptional items grew by 9.9% to Kshs 9.8 bn, from Kshs 8.9 bn in FY'2018, while profit after tax and exceptional items, which relates to merger costs of Kshs 2.0 bn, declined by 12.4% to Kshs 7.8 bn in FY'2019 from Kshs 8.9 bn in FY'2018, with the effective tax rate increasing to 30.7% from 27.1% in FY'2018,
- Total operating income declined by 7.6% to Kshs 33.7 bn in FY'2019, from Kshs 36.4 bn in FY'2018. This was driven by a 34.2% decline in Net Interest Income (NII) to Kshs 13.3 bn from Kshs 20.3 bn recorded in 2018 which outpaced the 25.9% growth in Non-Funded Income (NFI) to Kshs 20.3 bn in FY'2019 from Kshs 16.1 bn in FY'2018,
- Total operating expenses declined by 15.7% to Kshs 20.4 bn, from Kshs 24.2 bn in FY'2018, largely driven by a 26.0% decline in staff costs to Kshs 5.6 bn, from Kshs 7.5 bn in FY'2018, coupled with a 19.1% decline in other operating expenses to Kshs 8.5 bn, from Kshs 10.5 bn in FY'2018,
- The balance sheet recorded an expansion as total assets increased by 9.1% to Kshs 494.8 bn, from Kshs 453.6 bn in FY'2018,
- The bank's asset quality deteriorated, with NPL ratio deteriorating to 12.6% in FY'2019 from 11.3% in FY'2018. The deteriorating NPL ratio is attributable to the faster 16.5% growth in gross non-performing loans, which outpaced the 4.7% growth in gross loans (after adding back interest suspense.
- Going forward, we expect the bank's growth to be driven by:

i. The completed merger has enabled NCBA to capitalize on the strengths of the previous entities. We expect the value or "dividends" from the merger to be experienced in 2020

Financial Statements Extracts

NCBA Group's PAT is expected to grow at a 5-year CAGR of 15.0%

Income Statement	2018	2019	2020F	2021F
Net Interest Income	20.3	13.3	17.6	22.2
Non Funded Income	16.1	20.3	18.2	18.7
Total Operating Income	**36.4**	**33.7**	**35.8**	**40.9**
Loan Loss Provision	(6.0)	(6.3)	(7.5)	(7.9)
Other Operating Expenses	(18.1)	(14.1)	(16.0)	(18.8)
Total Operating Expenses	**(24.1)**	**(20.4)**	**(23.5)**	**(26.7)**
Profit Before Tax	12.3	11.3	12.3	14.2
% PAT Change YoY	**9.3%**	**-12.4%**	**9.7%**	**15.8%**
EPS	12.7	11.1	5.7	6.7
DPS	0.0	0.3	0.3	0.3
Cost to Income	66.3%	60.5%	65.7%	65.2%
ROE	13.7%	11.8%	11.9%	12.2%
ROA	2.0%	1.7%	1.7%	1.9%
Balance Sheet				
Net Loans and Advances	239.6	249.4	252.7	273.0
Government Securities	129.7	145.0	134.1	144.9
Other Assets	84.3	100.5	131.3	139.2
Total Assets	453.6	494.8	518.2	557.0
Customer Deposits	341.0	378.2	388.8	419.9
Other Liabilities	46.2	49.3	51.3	51.7
Total Liabilities	387.2	427.6	440.1	471.6
Shareholders Equity	66.0	67.0	77.8	85.1
Number of Shares	0.7	0.7	1.5	1.5
Book value Per share	93.8	95.2	51.9	56.8
% Change in BPS YoY	**2.5%**	**1.5%**	**-45.4%**	**9.4%**

Cytonn

Valuation Summary

NCBA Group is undervalued with a total potential return of 47.2%

Cost of Equity Assumptions:	17-April-20
Risk free rate *	12.3%
Beta	1.0
Country Risk Premium	6.0%
Cost of Equity	18.3%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.3%
Return on Average Equity 2024	14.1%
Terminal Price to Book value per share	0.9x
Shareholder Equity (Kshs)- FY24e	118.9
Terminal Value (Kshs)- (Year 2024)	112.4

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	45.3	40.0%	18.1
Residual Valuation	33.6	35.0%	11.7
PBV Multiple	40.4	20.0%	8.1
PE Multiple	28.8	5.0%	1.4
Target Price			**39.4**
Current Price			**28.0**
Upside/(Downside)			40.9%
Dividend Yield			6.3%
Total Potential Return			**47.2%**

Cytonn

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

V. Standard Chartered Bank Kenya

Cytonn

SCBK's Summary of Performance – FY'2019

- Profit before tax increased by 2.8% to Kshs 12.2 bn, from Kshs 11.8 bn in FY'2018. Profit after tax grew by 1.7% to Kshs 8.2 bn in FY'2019, from Kshs 8.1 bn in FY'2018, as the effective tax rate increased to 32.3% from 31.6% in FY'2018,
- Total operating income increased marginally by 0.4% to Kshs 28.7 bn from Kshs 28.6 bn in FY'2018. The rise was due to a 0.3% increase in Non-Funded Income (NFI) to Kshs 9.23 bn from Kshs 9.20 bn in FY'2018, coupled with a 0.4% increase in Net Interest Income (NII) to Kshs 19.5 bn, from Kshs 19.4 bn in FY'2018,
- Total operating expenses declined by 1.3% to Kshs 16.5 bn, from Kshs 16.8 bn, largely driven by a 70.3% decline in loan loss provisions to Kshs 0.6 bn from Kshs 1.9 bn coupled with a 3.1% decline in staff costs to Kshs 7.1 bn, from Kshs 7.4 bn in FY'2018. The large decline in loan loss provisions was however offset by a 53.6% rise in depreciation and amortization charges to Kshs 1.3 bn from Kshs 0.8 bn in FY'2018,
- The balance sheet recorded an expansion as total assets increased by 5.9% to Kshs 302.1 bn, from Kshs 285.4 bn in FY'2018,
- The bank's asset quality improved, with the NPL ratio declining to 13.9%, from 16.3% in FY'2018. The improving NPL ratio is attributable to a 7.4% decline in gross non-performing loans to Kshs 20.1 bn, from Kshs 21.7 bn in FY'2018 compared to the 8.5% growth in gross loans to Kshs 144.5 bn, from Kshs 133.2 bn in FY'2018.
- Going forward, we expect the bank's growth to be driven by:

i. Continued focus on promoting the usage of the bank's alternative channels is likely to continue boosting the company's Non-Funded Income (NFI) as well as aiding in improving operational efficiency levels, which deteriorated in FY'2019 as evidenced by the worsening of the cost to income ratio to 55.6% from 51.8% in FY'2018. Revenue expansion coupled with cost containment will be key in boosting the bank's bottom line.

Cytonn

Financial Statements Extracts

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

Income Statement	2018	2019	2020e	2021f
Net Interest Income	19.4	19.5	19.5	22.4
Non Funded Income	9.2	9.2	8.9	9.7
Total Operating Income	**28.6**	**28.7**	**28.4**	**32.1**
Loan Loss Provision	(1.9)	(0.6)	(1.0)	(2.6)
Other Operating Expenses	(14.9)	(16.0)	(15.6)	(15.8)
Total Operating Expenses	**(16.8)**	**(16.5)**	**(16.6)**	**(18.4)**
Profit Before Tax	11.8	12.2	11.9	13.7
% PAT Change YoY	**17.1%**	**1.7%**	**0.8%**	**15.4%**
EPS	23.6	24.0	24.2	27.9
DPS	19.0	20.0	20.0	21.0
Cost to Income	58.6%	57.6%	58.3%	57.3%
NIM	**7.5%**	**7.4%**	**7.4%**	**8.4%**
ROaE	17.5%	17.5%	15.1%	15.1%
ROaA	2.8%	2.8%	2.7%	3.0%
Balance Sheet	**2018**	**2019**	**2020e**	**2021f**
Net Loans and Advances	118.7	128.7	117.4	130.2
Government Securities	98.7	99.6	104.1	104.7
Other assets	68.0	73.8	88.6	88.9
Total Assets	**285.4**	**302.1**	**310.1**	**323.8**
Customer Deposits	224.3	228.4	221.5	232.6
Other Liabilities	14.5	25.9	26.1	26.4
Total Liabilities	**238.8**	**254.4**	**247.6**	**259.0**
Shareholders Equity	**46.6**	**47.8**	**62.4**	**64.8**
Number of shares	**0.3**	**0.3**	**0.3**	**0.3**
Book value Per share	135.8	139.0	181.8	188.7
% Change in BPS YoY	**2.1%**	**2.4%**	**30.7%**	**3.8%**

Cytonn

Valuation Summary

SCBK is undervalued with a total potential return of 33.6%

Cost of Equity Assumptions:	17-April-20
Risk free rate *	12.3%
Beta	0.8
Country Risk Premium	6.0%
Cost of Equity	17.2%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.3%
Return on Average Equity 2024	16.3%
Terminal Price to Book value per share	1.8x
Shareholder Equity (Kshs) - FY24e	76.2
Terminal Value (Kshs)- (Year 2024)	144.1

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	278.1	40%	111.2
Residual Income	233.8	35%	81.8
PBV Multiple	122.1	20%	24.4
PE Multiple	122.1	5%	6.1
Target Price			**223.6**
Current Price			**182.3**
Upside/(Downside)			22.7%
Dividend Yield			11.0%
Total Return			**33.6%**

Cytonn

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

VI. Diamond Trust Bank Kenya

Cytonn

DTBK's Summary of Performance – FY'2019

- Profit before tax rose by 2.4% to Kshs 11.3 bn, from Kshs 11.0 bn in FY'2018. Profit after tax grew by 2.7% to Kshs 7.3 bn in FY'2019, from Kshs 7.1 bn in FY'2018, with the effective tax rate declining marginally to 35.5% from 35.6% in FY'2018,
- Total operating income declined by 3.8% to Kshs 24.5 bn from Kshs 25.5 bn in FY'2018. This was due to a 6.5% decline in Net Interest Income (NII) to Kshs 18.7 bn, from Kshs 20.0 bn in FY'2018, offsetting the 6.2% increase in Non-Funded Income (NFI) to Kshs 5.8 bn, from Kshs 5.4 bn in FY'2018,
- Total operating expenses declined by 8.7% to Kshs 13.2 bn from Kshs 14.5 bn in FY'2018, largely driven by the 55.6% decline in Loan Loss Provisions (LLP) to Kshs 1.3 bn from Kshs 3.0 bn in FY'2018 and, staff costs, which rose by 11.4%, to Kshs 4.7 bn from Kshs 4.2 bn in FY'2018. However, this was offset by other operating expenses which declined by 1.1% to Kshs 7.2 bn from Kshs 7.3 bn in FY'2018,
- The balance sheet recorded an expansion as total assets increased by 2.3% to Kshs 386.2 bn from Kshs 377.7 bn in FY'2018. This growth was largely driven by a 12.9% increase in government securities to Kshs 132.5 bn from Kshs 117.3 bn in FY'2018. The loan book on the other hand expanded by 3.1% to Kshs 199.1 bn from Kshs 193.1 bn in FY'2018.
- The bank's asset quality deteriorated, with the NPL ratio increasing to 7.6% from 6.7% in FY'2018. The decline in asset quality is attributable to a 16.9% increase in the gross NPLs to Kshs 15.9 bn in FY'2019 from Kshs 13.6 bn in FY'2018.
- Going forward, we expect the bank's growth to be driven by:

i. **Geographical diversification** - The bank's forays into other markets such as Tanzania, Uganda, and Burundi, may aid the bank's growth, given the lack of loan pricing controls in those markets. Continued focus on those markets would aid in alleviating the compressed interest income regime in the Kenyan market.

Financial Statements Extracts

DTBK's PAT is expected to grow at a 5-year CAGR of 7.5%

Income Statement	2017	2018f	2019f	2020f	2021f
Net Interest Income	19.7	20.0	18.7	20.0	21.0
Non Funded Income	5.3	5.4	5.8	5.7	4.5
Total Operating Income	**25.0**	**25.5**	**24.5**	**25.7**	**25.4**
Loan Loss Provision	4.3	3.0	1.3	4.3	2.0
Other Operating Expenses	10.6	11.5	11.9	11.2	11.9
Total Operating Expenses	**14.9**	**14.5**	**13.2**	**15.5**	**13.9**
Profit Before Tax	10.1	11.0	11.3	10.2	11.5
% PAT Change YoY	**-10.3%**	**2.3%**	**2.7%**	**-1.7%**	**9.7%**
EPS	24.8	23.9	24.3	23.9	26.3
DPS	2.6	2.6	2.7	3.0	3.0
Cost to Income	59.6%	56.9%	54.0%	60.3%	54.6%
NIM	**6.5%**	**6.2%**	**5.6%**	**6.0%**	**6.3%**
ROE	14.4%	13.9%	12.9%	10.6%	9.9%
ROA	2.0%	1.9%	1.9%	1.8%	1.9%
Balance Sheet	**2017**	**2018f**	**2019f**	**2020f**	**2021f**
Net Loans and Advances	196.0	193.1	199.1	197.8	206.7
Government Securities	112.5	115.0	130.3	114.7	118.1
Other Assets	54.7	69.6	56.8	88.4	92.4
Total Assets	**363.3**	**377.7**	**386.2**	**400.9**	**417.1**
Customer Deposits	266.2	282.9	280.2	286.6	295.2
Other Liabilities	43.4	35.9	41.5	32.7	33.8
Total Liabilities	**309.7**	**318.8**	**321.7**	**319.3**	**329.1**
Shareholders Equity	48.4	53.7	58.9	75.9	82.4
Number of Shares	0.3	0.3	0.3	0.3	0.3
Book value Per share	173.0	191.9	210.5	271.3	294.6
% Change in BPS YoY	**17.9%**	**10.9%**	**9.7%**	**28.9%**	**8.6%**

Cytonn

Valuation Summary

SCBK is undervalued with a total potential return of 113.2%

Cost of Equity Assumptions:	17-April-20
Risk free rate *	12.3%
Beta	0.9
Country Risk Premium	6.0%
Cost of Equity	19.1%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.8%
Return on Average Equity 2024	10.2%
Terminal Price to Book value per share	0.8x
Shareholder Equity (Kshs)- FY24e	106.4
Terminal Value (Kshs)- (Year 2024)	89.4

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	217.4	40.0%	86.9
Residual Income	110.0	35.0%	38.5
PBV Multiple	232.3	20.0%	46.5
PE Multiple	155.0	5.0%	7.7
Target Price			**179.9**
Current Price			**85.5**
Upside/(Downside)			110.1%
Dividend yield			3.0%
Total return			**113.2%**

Cytonn

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

VII. Absa Bank Kenya

Cytonn

Absa Bank's Summary of Performance – FY'2019

- Profit before and exceptional item tax rose by 15.4% to Kshs 12.3 bn, from Kshs 10.6 bn in FY'2018. Profit after tax before exceptional items grew by 21.2% to Kshs 9.0 bn in FY'2019, from Kshs 7.4 bn in FY'2018, while profit after tax and exceptional items, which relates to a one-off transition expense of Kshs 1.5 bn, grew by a marginal 0.5% to Kshs 7.5 bn in FY'2019, from Kshs 7.4 bn in FY'2018, with the effective tax rate increasing to 30.7% from 30.0% in FY'2018,
- Total operating income rose by 6.5% to Kshs 33.8 bn, from Kshs 31.7 bn in FY'2018. This was due to a 9.1% rise in Non-Funded Income (NFI) to Kshs 10.6 bn, from Kshs 9.7 bn in FY'2018, coupled with a 5.4% rise in Net Interest Income (NII) to Kshs 23.2 bn, from Kshs 22.0 bn in FY'2018,
- Total operating expenses rose by 2.1% to Kshs 21.5 bn from Kshs 21.1 bn, largely driven by an 8.5% increase in Loan Loss Provisions (LLP) to Kshs 4.2 bn in FY'2019, from Kshs 3.9 bn in FY'2018, coupled with a 4.0% increase in staff costs to Kshs 10.2 bn in FY'2019, from Kshs 9.8 bn in FY'2018, with the bank has hired an additional 463 staff as it undertook rebranding in 2019,
- The balance sheet recorded an expansion as total assets increased by 15.1% to Kshs 374.0 bn, from Kshs 324.8 bn in FY'2018.
- The bank's asset quality improved, with the NPL ratio improving to 6.6% from 7.4% in FY'2018. The improving NPL ratio is attributable to a 2.8% decline in gross non-performing loans to Kshs 13.5 bn, from Kshs 13.9 bn in FY'2018 compared to the 9.8% growth in gross loans in FY'2018.
- Going forward, we expect the bank's growth to be driven by:

i. **Increased Channel diversification-**which is likely to help the bank to continue improving its operational efficiency. The benefits of this are already being felt with "Timiza" already recording accelerated growth, and consequently higher Non-Interest. This coupled with the expansion of its agent-banking network and product offerings such as bancassurance and fixed income trading will see the bank expand its topline revenue, going forward.

Cytonn

Financial Statements Extracts

Absa Bank's PAT is expected to grow at a 5-year CAGR of 9.9%

Income Statement	2018	2019	2020f	2021f
Net Interest Income	22.0	23.2	27.5	28.9
Non Funded Income	9.7	10.6	10.7	11.6
Total Operating Income	**31.7**	**33.8**	**38.2**	**40.4**
Loan Loss Provision	(3.9)	(4.2)	(4.9)	(5.6)
Other Operating Expenses	(17.2)	(17.3)	(20.1)	(21.0)
Total Operating Expenses	**(21.1)**	**(21.5)**	**(25.0)**	**(26.6)**
Profit Before Tax	10.6	10.8	13.2	13.8
% PAT Change YoY	**7.1%**	**0.5%**	**23.8%**	**4.8%**
EPS	1.4	1.4	1.7	1.8
DPS	1.1	1.1	1.1	1.1
Cost to Income	66.4%	63.6%	65.5%	65.8%
NIM	**8.6%**	**7.7%**	**8.6%**	**9.0%**
ROaE	16.8%	16.7%	17.3%	15.2%
ROaA	2.7%	2.1%	2.4%	2.4%
Balance Sheet	**2018**	**2019**	**2020f**	**2021f**
Net Loans and Advances	177.4	194.9	195.1	212.4
Government Securities	92.9	123.0	119.0	100.0
Other Assets	54.5	56.1	78.4	96.2
Total Assets	**324.8**	**374.0**	**392.5**	**408.5**
Customer Deposits	207.4	237.7	238.0	249.9
Other Liabilities	73.2	91.1	92.9	93.3
Total Liabilities	**280.6**	**328.8**	**330.9**	**343.2**
Shareholders Equity	**44.2**	**45.2**	**61.6**	**65.3**
Number of shares	**5.4**	**5.4**	**5.4**	**5.4**
Book value Per share	8.1	8.3	11.3	12.0
% Change in BPS YoY	**0.2%**	**2.2%**	**36.4%**	**6.0%**

Cytonn

Valuation Summary

Absa Bank is undervalued with a total potential return of 38.7%

Cost of Equity Assumptions:	17-April-20
Risk free rate *	12.3%
Beta	1.1
Country Risk Premium	6.0%
Cost of Equity	18.6%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.3%
Return on Average Equity 2024	15.4%
Terminal Price to Book value per share	1.5x
Shareholder Equity (Kshs)- FY24e	80.5
Terminal Value (Kshs)- (Year 2024)	122.6

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	14.7	40.0%	5.9
Residual Income	13.6	35.0%	4.8
PBV Multiple	8.0	20.0%	1.6
PE Multiple	7.1	5.0%	0.4
Target Price			**12.6**
Current Price			**9.9**
Upside/(Downside)			27.6%
Dividend Yield			11.2%
Total Return			**38.7%**

Cytonn

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

VIII. Stanbic Holdings

Stanbic Holdings' Summary of Performance – FY'2019

- Profit before tax declined by 13.8% to Kshs 7.7 bn from Kshs 9.0 bn in FY'2018, while profit after tax (PAT) increased by 1.6% to Kshs 6.4 bn, from Kshs 6.3 bn in FY'2018, owing to a decrease in the effective tax rate to 17.2% from 29.8% in FY'2018,
- Total operating income rose by 12.2% to Kshs 24.8 bn, from Kshs 22.1 bn in FY'2018, driven by a 14.7% increase in Non-Funded Income to Kshs 11.4 bn in FY'2019, from Kshs 10.0 bn in FY' 2018, coupled with a 10.0% increase in Net Interest Income to Kshs 13.4 bn, from Kshs 12.1 bn in FY'2018,
- Total operating expenses increased by 25.6% to Kshs 13.9 bn in FY'2019 from Kshs 11.1 bn in FY'2018, largely driven by a 50.8% increase in the loan loss provision to Kshs 2.6 bn from Kshs 1.7bn in FY'2018,
- The balance sheet recorded an expansion as total assets increased by 4.5% to Kshs 303.6 bn from Kshs 290.6 bn in FY'2018. This growth was largely driven by a 9.3% increase in the loan book to Kshs 191.2 bn from Kshs 175.0 bn,
- The bank's asset quality deteriorated with the NPL ratio increasing to 9.6% from 9.1% in FY'2018. The deteriorating NPL ratio is attributable to a 16.2% increase in gross non-performing loans to Kshs 19.3 bn, from Kshs 16.6 bn in FY'2018,
- Going forward, we expect the bank's growth to be driven by:

i. **Efficient operating model-** The bank's increased focus on cost containment is likely to boost the bank's growth prospects, as it looks to drive its strategy of increased deposit mobilization capacity and lending. This will likely ring in additional interest income, thereby improving the top line revenue. Furthermore, the banks well diversified revenue structure will likely buffer the bottom in the event of a significant decline in one of the revenue streams

Financial Statements Extracts

Stanbic Holdings' PAT is expected to grow at a 5-year CAGR of 14.4%

Income Statement	2018	2019	2020e	2021f
Net Interest Income	12.1	13.3	14.2	15.9
Non Funded Income	10.0	11.4	9.5	12.2
Total Operating Income	**22.1**	**24.8**	**23.6**	**28.1**
Loan Loss Provision	(1.7)	(2.6)	(2.8)	(3.0)
Other Operating Expenses	(9.3)	(11.3)	(11.8)	(14.3)
Total Operating Expenses	**(11.1)**	**(13.9)**	**(14.7)**	**(17.4)**
Profit Before Tax after Exceptional Item	8.9	7.7	9.0	10.7
% PAT Change YoY	**45.7%**	**1.6%**	**5.7%**	**11.1%**
EPS	15.9	16.1	17.1	19.0
DPS	5.8	7.1	6.8	6.3
Cost to Income	42.3%	45.6%	50.0%	51.0%
NIM	**5.0%**	**5.2%**	**5.1%**	**5.4%**
ROaE	14.3%	13.6%	12.7%	12.6%
ROaA	2.3%	2.1%	2.1%	2.2%
Balance Sheet	**2018**	**2019**	**2020e**	**2021f**
Net Loans and Advances	175.0	191.2	192.1	214.3
Other Assets	115.6	112.4	131.9	143.2
Total Assets	**290.6**	**303.6**	**324.0**	**357.5**
Customer Deposits	219.5	224.7	237.2	265.7
Borrowings	7.1	9.1	9.1	9.1
Other Liabilities	19.4	20.8	20.8	20.8
Total Liabilities	**245.9**	**254.6**	**267.1**	**295.6**
Shareholders Equity	44.6	49.0	56.9	61.9
No of Ordinary Shares	0.4	0.4	0.4	0.4
Book value Per share	112.9	124.0	144.0	156.6
% Change in BVPS	**3.9%**	**9.9%**	**16.1%**	**8.8%**

Valuation Summary

Stanbic Holdings is undervalued with a total potential return of 24.7%

Cost of Equity Assumptions:	17-April-20
Risk free rate *	12.3%
Beta	1.0
Country Risk Premium	6.0%
Cost of Equity	19.4%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.4%
Return on Average Equity 2024	15.6%
Terminal Price to Book value per share	0.9x
Shareholder Equity (Kshs) - FY24e	85.0
Terminal Value (Kshs) - (Year 2024)	83.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	124.0	40.0%	49.6
Residual income	111.5	35.0%	39.0
PBV Multiple	86.1	20.0%	17.2
PE Multiple	79.9	5.0%	4.0
Target Price			**109.8**
Current Price			**93.8**
Upside/(Downside)			17.2%
Dividend Yield			7.5%
Total return			**24.7%**

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

IX. I&M Holdings

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I&M Holdings' Summary of Performance – FY'2019

- Profit before tax rose by 27.0% to Kshs 14.6 bn, up from Kshs 11.5 bn in FY'2018. Profit after tax grew by 26.6% to Kshs 10.8 bn in FY'2019, from Kshs 8.5 bn in FY'2018, with the effective tax rate increasing to 34.2%, from 30.5% in FY'2018,
- Total operating income rose by 2.6% to Kshs 23.8 bn, from Kshs 23.2 bn in FY'2018. This was driven by a 9.1% increase in Non-Funded Income (NFI) to Kshs 8.3 bn, from Kshs 7.6 bn in FY'2018, offsetting the 0.5% decline in Net Interest Income (NII) to Kshs 15.5 bn, from Kshs 15.6 bn in FY'2018,
- Total operating expenses declined by 17.8% to Kshs 10.1 bn from Kshs 12.3 bn in FY'2018, largely driven by an 83.3% decline in Loan Loss Provisions (LLP) to Kshs 636.5 mn from Kshs 3.8 bn in FY'2018. There was however a 15.1% increase in staff costs to Kshs 4.7 bn from Kshs 4.1 bn in FY'2018,
- The balance sheet recorded an expansion as total assets grew by 9.3% to Kshs 315.4 bn, from Kshs 288.5 bn in FY'2018. The loan book also expanded by 5.2% to Kshs 175.3 bn from Kshs 166.7 bn in FY'2018,
- The bank's asset quality improved, with the NPL ratio improving to 11.3%, from 12.6% in FY'2018. NPL coverage also improved to 59.1%, up from 53.9% in FY'2018 as the 7.6% rise in general provisions to Kshs 8.6 bn, from Kshs 8.0 bn in FY'2018, outpaced the 5.3% decline in gross NPL to Kshs 21.3 bn in FY'2019 from Kshs 22.5 bn in FY'2018.
- Going forward, we expect the bank's growth to be driven by:

i. **Non-Funded Income Growth Initiatives –** I&M Holdings' NFI growth is improving as the bank focuses on digital innovation to augment transaction volumes and increase fee income. The bank needs to increase the capacity of its brokerage and advisory businesses to increase income contribution from investment and advisory services.

Financial Statements Extracts

I&M Holdings' PAT is expected to grow at a 5-year CAGR of 10.8%

Income Statement	2018	2019	2020F	2021F
Net Interest Income	15.6	15.5	17.8	23.5
Non- Funded Income	7.6	8.3	7.9	10.3
Total Operating Income	**23.2**	**23.8**	**25.8**	**33.8**
Loan Loss Provision	(3.8)	(0.6)	(1.9)	(3.2)
Other Operating Expenses	(8.5)	(9.5)	(10.1)	(12.5)
Total Operating Expenses	**(12.3)**	**(10.1)**	**(12.0)**	**(15.7)**
Profit Before Tax and Share from Associate	11.5	14.6	14.7	19.0
% PAT Change YoY	**17.1%**	**26.6%**	**(4.6%)**	**29.4%**
EPS	20.6	13.0	12.4	16.1
DPS	3.9	2.6	2.6	2.6
Cost to Income	53.0%	42.4%	46.6%	46.5%
NIM	6.7%	5.9%	6.3%	7.6%
ROaE	17.2%	19.5%	13.6%	15.6%
ROaA	3.0%	3.4%	3.0%	3.5%
Balance Sheet	**2018**	**2019**	**2020F**	**2021F**
Government securities	52.2	53.9	58.1	64.0
Net Loans and Advances	166.7	175.3	188.0	217.7
Other Assets	69.6	86.0	108.1	114.7
Total Assets	**288.5**	**315.3**	**354.3**	**396.4**
Customer Deposits	213.1	229.7	247.4	272.2
Other Liabilities	24.5	24.7	24.1	30.3
Total Liabilities	**237.6**	**254.4**	**271.5**	**302.5**
Shareholders Equity	47.9	57.7	79.6	90.8
Number of Shares	0.4	0.8	0.8	0.8
Book Value Per Share	115.8	69.8	96.3	109.8
% BVPS Change YoY	**8.0%**	**-39.7%**	**37.9%**	**14.1%**

Valuation Summary

I&M Holdings is undervalued with a total potential return of 49.2%

Cost of Equity Assumptions:	17-April-20
Risk free rate *	12.3%
Beta	0.8
Country Risk Premium	6.0%
Cost of Equity	17.6%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.8%
Return on Average Equity 2024	14.4%
Terminal Price to Book value per share	0.9x
Shareholder Equity (Kshs)- FY24e	133.1
Terminal Value (Kshs) - (Year 2024)	118.7

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	98.3	40.0%	39.3
Residual income	57.3	35.0%	20.1
PBV Multiple	52.7	20.0%	10.5
PE Multiple	73.1	5.0%	3.7
Target Price			**73.6**
Current Price			**51.0**
Upside/(Downside)			44.2%
Dividend yield			5.0%
Total return			**49.2%**

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

B. Tier II Bank

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I. HF Group

HF Group Summary of Performance – FY'2019

- HF Group recorded a loss before tax of Kshs 137.8 mn a decline from a loss before tax of Kshs 642.7 mn in FY'2018. The Group's Loss after Tax declined to Kshs 110.1 mn in FY'2019, from the Kshs 598.2 mn loss recorded in FY'2018,
- Total Operating Income declined by 6.0% to Kshs 3.4 bn in FY'2019 from Kshs 3.6 bn, this can be attributed to the 13.2% decline in Net Interest Income (NII) to Kshs 2.0 bn from Kshs 2.3 bn recorded in FY'2018, coupled with the 6.4% increase in Non-funded Income (NFI) to Kshs 1.4 bn from Kshs 1.3 bn seen in 2018,
- Total Operating Expenses declined by 17.1% to Kshs 3.5 bn from Kshs 4.2 bn seen in FY'2018. This is attributable to a 20.9% drop in Other Expenses to Kshs 2.0 bn from Kshs 2.6 bn in 2018, coupled with a 12.1% decline in Staff Costs from Kshs 1.2 bn to Kshs 1.1 bn in FY'2019, and a 6.8% decline in Loan Loss Provisions to Kshs 350.4 mn from Kshs 375.9 mn recorded in 2018,
- The balance sheet recorded an expansion as total assets declined by 6.8% from Kshs 60.5 bn to Kshs 56.5 bn in FY'2019.
- The bank experienced an improvement in asset quality as Non-performing Loans (NPLs) decreased by 7.6% to Kshs 12.3 bn from Kshs 13.3 bn recorded in 2018. Consequently, the NPL ratio improved marginally to 27.7% from the 27.8% following the faster 7.6% decline in NPLs that outpaced the 7.5% decline in gross loans that came in at Kshs 44.4 bn in FY'2019 from Kshs 48.0 bn recorded in 2018.Going forward, we expect the bank's growth to be driven by:

i. We maintain our view that HF Group as a conventional bank has a long way to go. They will ultimately have to adjust their business model, or couple up with a strong bank with a sizeable asset base, and a strong deposit gathering capability, in an effort to capitalize on HF's strength in mortgages and real estate development.

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Financial Statements Extracts

HF Group's PAT is expected to grow at a 5-year CAGR of 19.0%

Income Statement	2018	2019	2020F	2021F
Net Interest Income	2.3	2.0	1.8	2.5
Non Funded Income	1.3	1.4	1.6	1.8
Total Operating Income	**3.6**	**3.4**	**3.4**	**4.3**
Loan Loss Provision	(0.4)	(0.4)	(0.3)	(0.6)
Other Operating Expenses	(3.8)	(3.2)	(3.1)	(3.7)
Total Operating Expenses	**(4.2)**	**(3.5)**	**(3.5)**	**(4.3)**
Profit Before Tax	(0.6)	(0.1)	(0.0)	0.0
EPS	(1.6)	(0.3)	(0.1)	0.0
DPS	0.0	0.0	0.0	0.0
Cost to Income	118.2%	104.2%	100.9%	99.5%
ROE	(5.5%)	(1.1%)	(0.2%)	0.1%
ROA	(0.9%)	(0.2%)	0.0%	0.0%
Balance Sheet	**2018**	**2019**	**2020F**	**2021F**
Net Loans and Advances	43.4	38.6	41.3	44.5
Government Securities	3.2	4.6	4.5	4.5
Other Assets	13.9	13.3	12.9	12.4
Total Assets	**60.5**	**56.5**	**58.6**	**61.5**
Customer Deposits	34.7	37.4	40.0	42.8
Other Liabilities	15.5	8.8	8.8	8.9
Total Liabilities	**50.2**	**46.2**	**48.9**	**51.7**
Shareholders Equity	10.4	10.2	10.2	10.2
Number of Shares	0.4	0.4	0.4	0.4
Book value Per share	27.0	26.6	26.5	26.5
% Change in BPS YoY	**(17.0%)**	**(1.5%)**	**(0.2%)**	**0.1%**

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Valuation Summary

HF Group is undervalued with a total potential return of 2.5%

Cost of Equity Assumptions:	16-April-20
Risk free rate *	12.3%
Beta	1.1
Country Risk Premium	6.0%
Cost of Equity	19.1%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.3%
Return on Average Equity 2023	2.5%
Terminal Price to Book value per share	0.2x
Shareholder Equity (Kshs)- FY23e	10.7
Terminal Value (Kshs) - (Year 2023)	2.2

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	3.3	40.0%	1.3
Residual Income	3.3	35.0%	1.1
PTBV Multiple	7.1	20.0%	1.4
PE Multiple	8.5	5.0%	0.4
Fair Value			**4.3**
Current Price			**4.2**
Upside/(Downside)			2.5%
Dividend Yield			0.0%
Total return			***2.5%***

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

Feedback Summary

During the preparation of this FY'2019 Banking Sector Report, we shared with the subject companies the operating metrics that were used in the Report 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	Unresponsive
I&M Holdings	Yes	Yes
KCB Group	Yes	Unresponsive
Standard Chartered Bank Kenya	Yes	Unresponsive
NCBA Group	Yes	Yes
Diamond Trust Bank	Yes	Yes
Housing Finance Group	Yes	Unresponsive
Stanbic Holdings	Yes	Unresponsive
Equity Group Holdings	Yes	Unresponsive
Absa Bank Kenya	Yes	Unresponsive
National Bank of Kenya	Yes	Unresponsive

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Thank You!

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Q&A / AOB

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