

Valuation Summary

- We are of the view that I&M Holdings is a “Buy” with a target price of Kshs 150.4, representing a upside of 23.1%, from the current price of Kshs 125.0 as of 28th March, inclusive of a dividend yield of 2.8%,
- I&M Holdings is currently trading at P/TBV of 1.4x and a P/E of 7.6x vs an industry average of 1.4x and 8.8x, respectively.

Key highlights FY'2017

- During the year, I&M Holdings announced the successful completion of a 100.0% acquisition of Giro Commercial Bank Limited (GCBL) for Kshs 5.0 bn and 21.0 mn shares to be part of I&M Bank Limited (IMBL), in a bid to increase the bank’s footprint and market share in the country

Income Statement

- Core earnings per share declined by 7.1% to Kshs 16.5 per share from Kshs 17.7, outperforming our expectations of a 9.4% decline. The performance is due to a 15.9% increase in total operating expenses, despite a 4% increase in operating income,
- Total operating income increased by 4.0% to Kshs 21.3 bn from 20.5 bn, driven by a 15.9% increase in Non-Funded Income (NFI), coupled with a 0.6% increase in Net Interest Income (NII). NII increased by 0.6% to Kshs 15.6 bn from Kshs 15.5 bn in FY'2016, while NFI increased by 15.9% to Kshs 5.8 bn from Kshs 5.0 bn in FY'2016,
- Total Interest income declined by 0.1% to Kshs 24.4 bn from Kshs 24.5 bn in FY'2016. The interest income on loans and advances declined by 1.8% to Kshs 18.9 bn from 19.2 bn, while interest income on government securities increased by 6.0% to Kshs 5.4 bn from Kshs 5.1 bn in FY'2016. As a result, the yield on interest-earning assets decreased to 7.8 % from 9.2% in FY'2016,
- Interest expense remained relatively unchanged at Kshs 8.9 bn, similar to FY'2016. Interest expense on customer deposits increased by 15.5% to Kshs 169.3 bn from Kshs 146.5 bn in FY'2016. Cost of funds decreased to 4.7% from 5.9% in FY'2016. The net interest income increased by 0.6% to Kshs 15.6 bn from 15.5 bn. The Net Interest Margin declined to 7.8% from 9.2%,
- Non-Funded Income (NFI) increased by 15.9% to Kshs 5.8 bn from Kshs 5.0 bn in FY'2016. The growth in NFI was driven by a 38.3% increase in other income to Kshs 0.6 bn from Kshs 0.4 bn in FY'2016. Forex income remained relatively unchanged at Kshs 1.8 bn, similar to FY'2016. Income from fees and commissions increased by 22% to Kshs 2.3bn from Kshs 1.9bn. The current revenue mix stands at 73:27 funded to non-funded income from the 76:24 recorded in FY'2016, owing to an increase in NFI.
- Total operating expenses increased by 15.9% to Kshs 12.0 bn from Kshs 10.3 bn, largely driven by a 39.8% increase in the loan loss provision to Kshs 4.1 bn from Kshs 3.0 bn in FY'2016. Staff costs increased by 4.4% to Kshs 3.8 bn from Kshs 3.6 bn in FY'2016
- The cost to income ratio worsened to 56.2% from 50.4% in FY'2016, due to the rise in loan loss provisioning in 2017. Without LLP, the Cost to income ratio also worsened, albeit marginally to 36.8% in FY'2017 from 36.0% in FY'2016,
- Profit before tax declined by 6.7% and stood at Kshs 9.9 bn down from Kshs 10.6 bn. Profit after tax declined 7.1% to Kshs 6.8 bn from Kshs 7.3 bn in FY'2016.
- The bank recommends a final dividend of Kshs 3.5 per share which translates to a dividend yield of 2.8%.

Balance Sheet

- Total assets increased by 14.0% to Kshs 240.1 bn from Kshs 210.5 bn in FY'2016. This growth was largely driven by an increase in the loan book by 13.6% to Kshs 153.0 bn from Ksh 134.7 bn. In addition investment in government securities increased by 10.9% to stand at Kshs 50.8 bn from Kshs 45.8 bn in FY'2016,
- Total liabilities rose by 12.9% to Kshs 193.1 bn from Kshs 171.0 bn in FY'2016, driven by a 15.5% increase in customer deposits to Kshs 169.3 bn from Kshs 146.5 bn in FY'2016. Deposits per branch closed the year at Kshs 4.0 bn up by 15.5% from Kshs 3.5 bn in FY'2016,
- The faster increase in the deposits as compared to the loans lead to a decrease in the loan to deposit ratio to 90.4% in FY'2017 from 91.9% in FY 2016.
- Gross non-performing loans increased by 106.7% to Kshs 19.5 bn from Kshs 9.4 bn. The NPL ratio as a consequence deteriorated to 11.1% in FY'2017 from 5.9% in FY'2016 as NPLs increased at a higher rate than the loan book.
- Shareholders' funds increased by 19.7% to Kshs 44.3 bn from Kshs 37.0 bn in FY'2016. This is largely due to the 24.2% increase in retained earnings to Kshs 22.6 bn from Kshs 18.2 bn.
- I&M Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 18.7%, 8.2% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 21.0%, exceeding the statutory requirement by 6.5%.
- The bank recommends a final dividend of Kshs 3.5 per share, subject to shareholders' approval. The proposed dividend per share has remained constant. The dividend yield stood at 2.8% in FY'2017

Key Take out:

- a) The relatively challenging macroeconomic environment coupled with the effects of the interest rate cap compressed the bank's interest income.

Going forward, we expect I&M Holdings growth to be propelled by:

- i. Improvements in asset quality, with the increase in NPLs causing Gross Non-Performing loans ratio to deteriorate to 11.1% which is above peer average of 8.2%,
- ii. Improvements in cost efficiency with the total operating expenses increasing by 15.9% to Kshs 12.0 bn from Kshs 10.3 bn, largely driven by a 39.8% increase in the loan loss provision to Kshs 4.1 bn in FY 2017 from Kshs 3.0 bn in FY'2016. The cost to income ratio worsened to 56.2% from 50.4% in FY'2016,
- iii. Diversification to more fee income business in order to shore up their Non-Funded Income. The NFI to operating income ratio for I&M bank stood at 27% below the market average of 34.0%.

Below is a summary of the key line items in the balance sheet and income statement
Figures in Ksh billions unless otherwise stated

Balance Sheet	FY'2016	FY'2017	y/y change	FY'2017e	Expected y/y change	Variance in Actual Growth vs. Expected
Government Securities	45.8	50.8	10.9%	57.5	25.6%	(14.7%)
Net Loans and Advances	134.7	153.0	13.6%	151.2	12.3%	1.3%
Total Assets	210.5	240.1	14.1%	245.1	16.4%	(2.4%)
Customer Deposits	146.5	169.3	15.5%	168.1	14.7%	0.8%
Total Liabilities	171.0	193.1	12.9%	194.4	13.7%	(0.7%)
Shareholders Funds	37.0	44.3	19.7%	48.3	30.5%	(10.8%)

Income Statement	FY'2016	FY'2017	y/y change	FY'2017e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	15.5	15.6	0.6%	14.0	(9.8%)	10.5%
Net non-Interest Income	5.0	5.8	15.9%	5.8	16.6%	(0.8%)
Total Operating income	20.5	21.3	4.0%	19.8	(3.5%)	7.5%
Loan Loss provision	3.0	4.1	39.8%	3.1	6.4%	33.4%
Total Operating expenses	10.3	12.0	15.9%	10.8	4.6%	11.3%
Profit before tax	10.6	9.9	(6.7%)	9.0	(15.4%)	8.7%
Profit after tax	7.3	6.8	(7.1%)	6.3	(13.8%)	6.7%
Core EPS	17.7	16.5	(7.1%)	16.0	(9.7%)	2.6%

Balance sheet ratios	FY'2016	FY'2017	% y/y change
Loan to Deposit Ratio	91.9%	90.4%	(1.5%)
Return on average equity	23.4%	16.8%	(6.6%)
Return on average assets	3.7%	3.0%	(0.7%)
Income statement ratios	FY'2016	FY'2017	% y/y change
Yield from interest-earning assets	8.5%	11.6%	3.1%
Cost of funding	5.9%	4.7%	(1.2%)
Net Interest Margin	9.2%	7.8%	(1.4%)
Cost to Income	36.0%	36.8%	0.8%
Cost to Assets	5.0%	4.9%	(0.1%)
Net Interest Income as % of operating income	75.7%	73.0%	(2.7%)
Non-Funded Income as a % of operating income	24.3%	27.0%	2.7%

Capital Adequacy Ratios	FY'2016	FY'2017
Core Capital/Total Liabilities	18.6%	19.2%
Minimum Statutory ratio	8.0%	8.0%
Excess	10.6%	11.2%
Core Capital/Total Risk Weighted Assets	18.4%	18.7%
Minimum Statutory ratio	10.5%	10.5%
Excess	7.9%	8.2%
Total Capital/Total Risk Weighted Assets	21.5%	21.0%
Minimum Statutory ratio	14.5%	14.5%
Excess	7.0%	6.5%
Liquidity Ratio	37.2%	35.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	17.2%	15.7%