

Valuation Summary

- We are of the view that I&M Holdings is a “Buy” with a target price of Kshs 79.8, representing an upside of 63.0%, from the current price of Kshs 49.0 as of 29th November, inclusive of a dividend yield of 7.2%,
- I&M Holdings is currently trading at P/TBV of 0.7x and a P/E of 4.6x vs an industry average of 1.4x and 7.2x, respectively.

Income Statement:

- I&M Holdings released their Q3'2019 results, registering core earnings per share growth of 13.4% to Kshs 16.0 from Kshs 14.2 in Q3'2018. Performance was driven by a 6.8% increase in operating income to Kshs 16.9 bn from Kshs 15.8 bn in Q3'2018, which outpaced the marginal increase in operating expenses by 0.5% to Kshs 8.23 bn from Kshs 8.18 bn recorded in Q3'2018,
- Total operating income increased by 6.8% to Kshs 16.9 bn from Kshs 15.8 bn in Q3'2018. This was due to a 14.0% increase in Non-Funded Income (NFI) to Kshs 6.3 bn from Kshs 5.6 bn in Q3'2018, coupled with a 2.9% growth in Net Interest Income (NII) to Kshs 10.6 bn from Kshs 10.3 bn recorded in Q3'2018,
- Interest income increased by 7.2% to Kshs 19.2 bn from Kshs 17.9 bn in Q3'2018. This was mainly driven by the 13.5% increase in interest income on loans and advances to Kshs 15.5 bn from Kshs 13.7 bn in Q3'2018. The growth was however mitigated by the 21.2% decline in interest income on government securities to Kshs 3.1 bn in Q3'2019 from Kshs 4.0 bn. The yields on interest earning assets stood at 10.1% in Q3'2019, a decline from 10.9% recorded in Q3'2018, due to a 17.2% increase in average interest earning assets to Kshs 269.5 bn from Kshs 230.0 bn which outpaced the 7.2% increase in interest income,
- Interest expense increased by 12.9% to Kshs 8.6 bn from Kshs 7.6 bn in Q3'2018, as interest expense on customer deposits increased by 21.3% to Kshs 7.8 bn from Kshs 6.4 bn in Q3'2018. Interest expense on deposits from other banking institutions however declined by 65.5% to Kshs 161.0 mn from Kshs 467.2 mn in Q3'2018. The cost of funds decreased marginally to 4.6% from 4.8% in Q3'2018, driven by a 27.3% increase in interest bearing liabilities to Kshs 239.2 bn from Kshs 176.3 bn which grew faster than interest expense which grew by 12.9%,
- Non-Funded Income increased by 14.0% to Kshs 6.3 bn from Kshs 5.6 bn in Q3'2018. The increase in NFI was driven by a 111.8% increase in other income to Kshs 1.2 bn from Kshs 558.8 mn in Q3'2018 coupled with an 11.1% increase in fees and commission income on loans to Kshs 1.4 bn from Kshs 1.2 bn in Q3'2018. Other fees and commissions increased by 1.1% to Kshs 1.9 bn from Kshs 1.8 bn in Q3'2018. The revenue mix shifted to 63:37 funded to non-funded income from 65:35 in Q3'2018, owing to the faster increase in NFI compared to NII,
- Total operating expenses posted a marginal growth of 0.5% to Kshs 8.23 bn from Kshs 8.18 bn, largely driven by a 13.6% increase in staff costs to Kshs 3.5 bn in Q3'2019 from Kshs 3.1 bn in Q3'2018, coupled with a 31.6% decline in Loan loss provisions (LLP) to Kshs 1.3 bn in Q3'2019 from Kshs 1.9 bn in Q3'2018,
- The cost to income ratio improved by 3.1% points to 48.6% from 51.7% in Q3'2018, driven by the faster increase of operating income compared to operating expenses. Without LLP, however, the cost to income ratio deteriorated to 40.9% from 39.9% in Q3'2018,
- Profit before tax recorded a 12.2% growth to Kshs 9.3 bn from Kshs 8.3 bn in Q3'2018. Profit after tax increased by 13.4% Kshs 6.3 bn in Q3'2019 from Kshs 5.5 bn recorded in a similar period in 2018, with the effective tax rate declining to 28.7% from 29.4%.

Balance Sheet:

- The balance sheet recorded an expansion with total assets growth of 12.0% to Kshs 324.3 bn from Kshs 289.6 bn recorded in Q3'2018. This growth was driven by a 6.6% increase in net loans and advances to Kshs 174.1 bn in Q3'2019 from Kshs 163.3 bn in Q3'2018, and a 9.2% growth in deposits and balances due from banking institutions abroad to Kshs 52.0 bn from Kshs 33.1 bn in Q3'2018. Government securities decreased by 0.7% to Kshs 53.5 bn from Kshs 53.9 bn in Q3'2018,
- Total liabilities recorded a growth of 11.2% to Kshs 266.7 bn from Kshs 239.8 bn recorded in Q3'2018, driven by a 13.0% increase in customer deposits to Kshs 236.2 bn from Kshs 209.0 bn in Q3'2018. Deposits per branch increased by 13.0% to Kshs 5.6 bn from Kshs 5.0 bn in Q3'2018 as the bank has not increased its branch network from the current 42 branches,
- The loan to deposit ratio decreased to 73.7% from 78.1% in Q3'2018, driven by the 13.0% growth in deposits to Kshs 236.2 bn from Kshs 209.0 bn in Q3'2018, which outpaced the 6.6% increase in net loans to Kshs 174.1 from Kshs 163.3 bn in Q3'2018,
- Gross non-performing loans increased by 8.9% to Kshs 24.1 bn in Q3'2019 from Kshs 22.1 bn in Q3'2018. However, the NPL ratio remained unchanged at 12.7% in Q3'2019. General loan loss provisions increased by 40.3% to Kshs 8.3 bn from Kshs 5.9 bn in Q3'2018, hence an improvement in NPL coverage to 62.5% in Q3'2019 from 49.2% in Q3'2018,
- Shareholders' funds increased by 16.0% to Kshs 54.5 bn from Kshs 47.0 bn recorded in Q3'2018 attributable to a 19.2% increase in retained earnings to Kshs 31.7 bn from Kshs 26.6 bn,
- I&M Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 15.9%, 5.4% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 19.4%, exceeding the statutory requirement by 4.9%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 16.0%, while total capital to risk weighted assets came in at 19.5%, indicating that the bank's total capital relative to its risk-weighted assets decreased by 0.1% due to the impact of IFRS 9,
- I&M Holdings currently has a return on average assets of 2.8% and a return on average equity of 17.2%.

Key Take-Outs:

- a. The bank maintained its continual rise in NFI recording a 14.0% growth to Kshs 6.3 bn from Kshs 5.6 bn in Q3'2018. This resulted in the revenue contribution mix shifting to 63:37 funded to non-funded income, from 65:35, owing to the high growth in NFI that outpaced growth in NII. The acquisition of Youjays Insurance Brokers in 2018 provides the bank with an avenue to grow its bancassurance business, thereby putting the firm's NFI on a positive growth trajectory, and,
- b. The bank's asset quality remained steady, with the NPL ratio flat-lining at 12.7% while NPL coverage improved to 62.5% in Q3'2019 from 49.2% in Q3'2018. Further, the 40.3% rise in general provisions to Kshs 8.3 bn from Kshs 5.9 bn in Q3'2018, outpaced the 8.9% growth in gross NPL to Kshs 24.1 bn in Q3'2019 from Kshs 22.1 bn in Q3'2018 thus leading to an improvement in the NPL coverage to 62.5% from 49.2% in Q3'2018.

Going forward, the factors that would drive the bank's growth would be:

- 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 capacity of its brokerage and advisory businesses so as to increase income contribution from investment and advisory services, and,

- ii. Geographical Diversification – The bank has been aggressively expanding into other regions, namely Tanzania, Rwanda and Uganda. This is expected to drive growth in the near future.

Below is a summary of the bank's performance;

Balance Sheet (mns)	Q3'2018	Q3'2019	y/y change	Q3'2019e	Expected y/y change	Variance in Actual Growth vs. Expected
Net Loans and Advances	163,327.4	174,111.3	6.6%	182,581.7	11.8%	(5.2%)
Total Assets	289,595.3	324,349.8	12.0%	333,617.2	15.2%	(3.2%)
Customer Deposits	209,040.9	236,229.0	13.0%	246,732.0	18.0%	(5.0%)
Total Liabilities	239,815.1	266,731.4	11.2%	275,802.4	15.0%	(3.8%)
Shareholders' Funds	47,009.1	54,518.8	16.0%	54,757.1	16.5%	(0.5%)

Balance sheet ratios	Q3'2018	Q3'2019	% y/y change
Loan to Deposit Ratio	78.1%	73.7%	(4.4%)
Return on average equity	17.2%	17.2%	0.0%
Return on average assets	2.9%	2.8%	(0.1%)

Income Statement(mns)	Q3'2018	Q3'2019	y/y change	Q3'2019e	Expected y/y change	Variance in Actual Growth vs. Expected
Net Interest Income	10,284.6	10,585.4	2.9%	11,183.5	8.7%	(5.8%)
Net non-Interest Income	5,560.3	6,339.1	14.0%	7,242.5	30.3%	(16.2%)
Total Operating income	15,844.9	16,924.5	6.8%	18,425.9	16.3%	(9.5%)
Loan Loss provision	(1,898.3)	(1,299.4)	(31.6%)	(1,746.6)	(8.0%)	(23.6%)
Total Operating expenses	(8,188.7)	(8,225.9)	0.5%	(8,964.1)	9.5%	(9.0%)
Profit before tax	8,290.7	9,302.7	12.2%	9,865.9	19.0%	(6.8%)
Profit after tax	5,850.8	6,634.7	13.4%	6,906.2	18.0%	(4.6%)
Core EPS	14.2	16.0	13.4%	16.7	18.0%	(4.6%)

Capital Adequacy Ratios	Q3'2018	Q3'2019
Core Capital/Total Liabilities	20.2%	20.0%
Minimum Statutory ratio	8.0%	8.0%
Excess	12.2%	12.0%
Core Capital/Total Risk Weighted Assets	15.3%	15.9%
Minimum Statutory ratio	10.5%	10.5%
Excess	4.8%	5.4%
Total Capital/Total Risk Weighted Assets	16.9%	19.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	2.4%	4.9%
Liquidity Ratio	47.8%	48.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	27.8%	28.7%
Adjusted Core Capital/Total Liabilities	20.25%	20.2%
Adjusted Core Capital/Total RWA	15.31%	16.0%
Adjusted Total Capital/Total RWA	17.33%	19.5%

