Kenya Listed Commercial Banks Review
Cytonn Q1'2019 Banking Sector Report

"Consolidation and Diversification to Drive Growth"

Cytonn

Sunday, 16th June 2019

I. Introduction to Cytonn

About Us

Cytonn Investments is an alternative investment manager with a primary focus on real estate investments in the high growth East African Region. In addition to real estate, Cytonn invests in educational facilities and hospitality, which are complimentary to its real estate developments. We have a unique strategy of coupling two compelling demand areas - the lack of high yielding investment products due to the large banking spread, and the lack of institutional grade real estate; by manufacturing high yielding instruments to attract funding from investors, and we deploy that funding to investment grade, well planned and comprehensive real estate developments that are largely pre-sold.

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

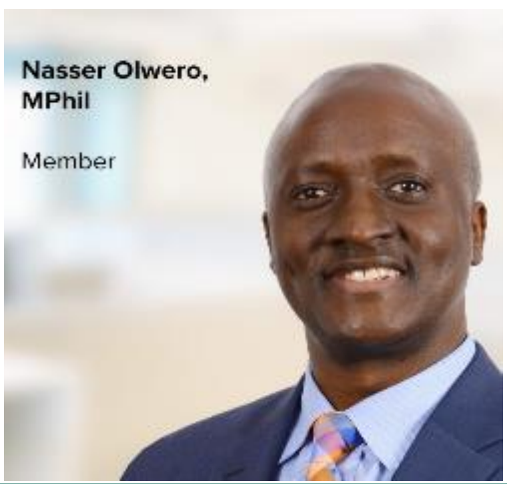
Our Business Structure

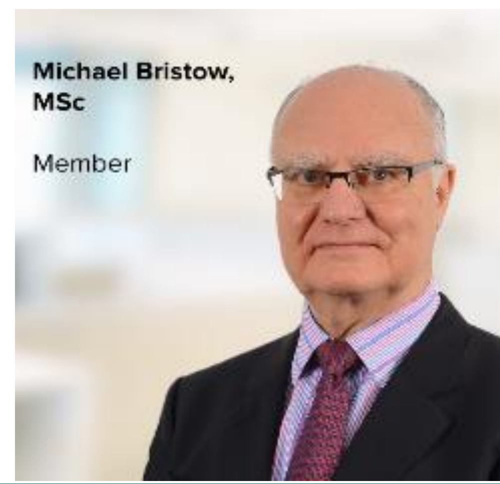
Cytonn Investments Management Plc

- **Cytonn Capital Partners** (Private Markets)
  - Private Offers and Real Estate Investments
  - Cytonn Hospitality
  - Cytonn Education Services
  - Superior Homes Kenya
  - Serviced Offices
- **Cytonn Asset Managers** (Regulated by Capital Markets Authority)
  - 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

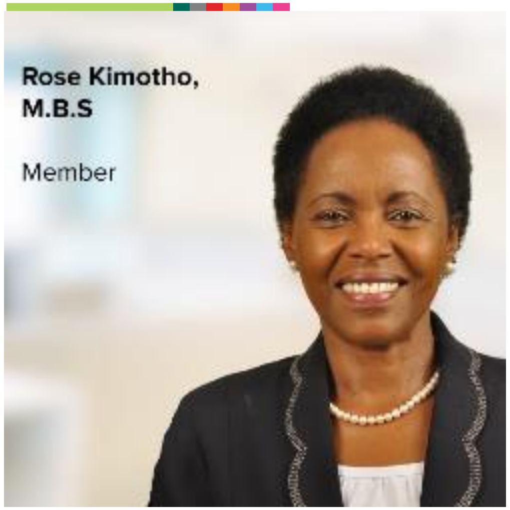
Board of Directors

To ensure that we remain focused on the clients' interests, we have put in place proper governance structures. We have a board of directors consisting of 12 members from diverse backgrounds, each bringing in unique skill-sets to the firm.





Board of Directors



Governance: Board Committees

Investments and Strategy Committee

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

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

Audit, Risk and Compliance Committee

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

- Madhav Bhalla, LLB (Chair)
- Nasser Olwero, Mphil
- Madhav Bhandari, MBA
- Patricia N. Wanjama, CPS

Human Resources, Governance & Compensation Committee

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

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

Technology and Innovation Committee

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

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

Management Team

Edwin H. Dande, MBA
Managing Partner & CEO

Elizabeth N. Nkukuu, CFA
Chief Investments Officer

Patricia N. Wanjama, CPS
Partner, Head of Legal & Company Secretary

Shiv A. Arora, BSc.
Head - Private Equity Real Estate

Maurice Oduor, BBA
Principal Officer, CAML

Daniel N. Mainye, MBA
Business Manager, Technologies

Anne Joseph, BA, CHRM
Assistant HR Manager

Grace W. Weru, BA, CPA(K)
Finance Manager, CAML

Management Team Cont..

Kimathi K. Muchiri, MSc, CPA (K)
Internal Audit Manager

Samuel Ng'ang'a
Finance Manager

Cytonn's Business Overview

Where we Raise Money	Where we Invest	How we Exit
Local High-net-worth Investors via a captive distribution of 250 Financial Advisors and 300 Independent Financial Advisors	**Real Estate –** 84.8%	Individuals i.e. Cytonn Distribution
Global & Local Institutions such as Taaleri of Finland	**Financial Services** - 4.6%	Institutions
Diaspora via our office in the Washington DC Metro Area	**Education** – 0.8%	**Investment Vehicles** Partnership Units (LLP) REIT's Fund Other Income Funds
Retail & Pension via Cytonn Asset Managers	**Hospitality -** 9.8%	
	Procurement – Just Started	

Strategic Support Services	**1. Finance**	**2. ICT**	**3. Legal & Compliance**	**4. Brand (PR & Communication)**	**5. CS**
	6.HR	**7. Risk**	**8. Business Admin**	**9. Fund Operations**	**10. Internal Audit**

II. Kenya Economic Review and Outlook

Kenya Economic Review

Of the 7 indicators we track, 3 are positive, 3 are neutral and 1 is negative. We maintain our positive outlook on the 2019 macroeconomic environment

Key Macro-Economic Indicators – Kenya			
Indicators	YTD 2019 experience and outlook going forward	Outlook-Beginning of Year	Current Outlook
GDP Growth	• The country's Gross Domestic Product (GDP), adjusted for inflation, rebounded in 2018 having expanded by 6.3% in 2018 from 4.9% recorded in 2017. This was the fastest economic growth since the 8.4% recorded in 2010, and above the 5-year average GDP growth rate of 5.4% • GDP growth is projected to range between 5.7%-5.9% in 2019, lower than the 6.3% growth in 2018, but higher than the 5-year historical average of 5.4%	Positive	Positive
Inflation	• Inflation is expected to remain within the government target range of 2.5% - 7.5%. Risk are however abound in the near-term, arising from the late onset of the traditionally long rains season which has disrupted food supply leading to a flare in food inflation, coupled with the continued rise in global fuel prices	Positive	Positive
Interest rates *Source – CBK*	• The interest rate environment has remained stable in 2019, with the CBR having been retained at 9.0% in the 3 MPC meetings held in 2019. With the heavy domestic maturities in 2019, we expect slight upward pressure on interest rates going forward, as the government tries to meet its domestic borrowing targets for the 2019/2020 fiscal year	Neutral	Neutral

Kenya Economic Review, continued…

Of the 7 indicators we track, 3 are positive, 3 are neutral and 1 is negative. We maintain our positive outlook on the 2019 macroeconomic environment

Key Macro-Economic Indicators – Kenya			
Indicators	**YTD 2019 experience and outlook going forward**	**Outlook-Beginning of Year**	**Current Outlook**
Currency	• The Kenya Shilling is expected to remain stable against the US Dollar in the range Kshs 101.0-Kshs 104.0 against the USD in 2019, with continued support from the CBK in the short term through its sufficient reserves currently at an all-time high of USD 10.1 bn (equivalent to 6.4-months of import cover)	**Neutral**	**Neutral**
Government Borrowing	• We still maintain our expectations of KRA not achieving their revenue targets having been raised by 14.2% in the FY'2019/2020 budget to Kshs 2.1 tn from the Kshs 1.9 tn . As per the Q3'2018/2019 Budget outturn, the Kenya Revenue Authority (KRA) had only managed to raise Kshs 1.2 tn against a target of Kshs 1.3 tn representing 91.5% of the targeted revenue collection and it is doubtful that it will meet its target. This is expected to result in further borrowing from the domestic market to plug in the deficit, which coupled with heavy maturities might lead to pressure on domestic borrowing • We also remain negative due to the ballooning public debt, as well as the maturity profile of the newly acquired debt as it is relatively short, which raises maturity concentration risk as the country will be in a continuous state of maturing obligations between 2024 and 2028	**Negative**	**Negative**

Source – CBK

Kenya Economic Review, continued…

Of the 7 indicators we track, 3 are positive, 3 are neutral and 1 is negative. We maintain our positive outlook on the 2019 macroeconomic environment

Key Macro-Economic Indicators – Kenya			
Indicators	**YTD 2019 experience and outlook going forward**	**Outlook Beginning of Year**	**Current Outlook**
Investor Sentiments	• Eurobond yields have been on a declining trend YTD. An improvement was also recorded in foreign inflows in the capital market to a net buying position of USD 5.6 mn in Q1'2019 from a net selling position of USD 93.4 mn in Q4'2018, an indication of improved investor sentiments. • We expect improved foreign inflows from the negative position in 2018, mainly supported by long term investors who enter the market looking to take advantage of the current cheap valuations in select sections of the market.	**Neutral**	**Neutral**
Security	• Security is expected to be upheld in 2019, given that the political climate in the country has eased. Despite the recent terror attack experienced during the quarter, Kenya was spared from travel advisories, evidence of the international community's confidence in the country's security position.	**Positive**	**Positive**

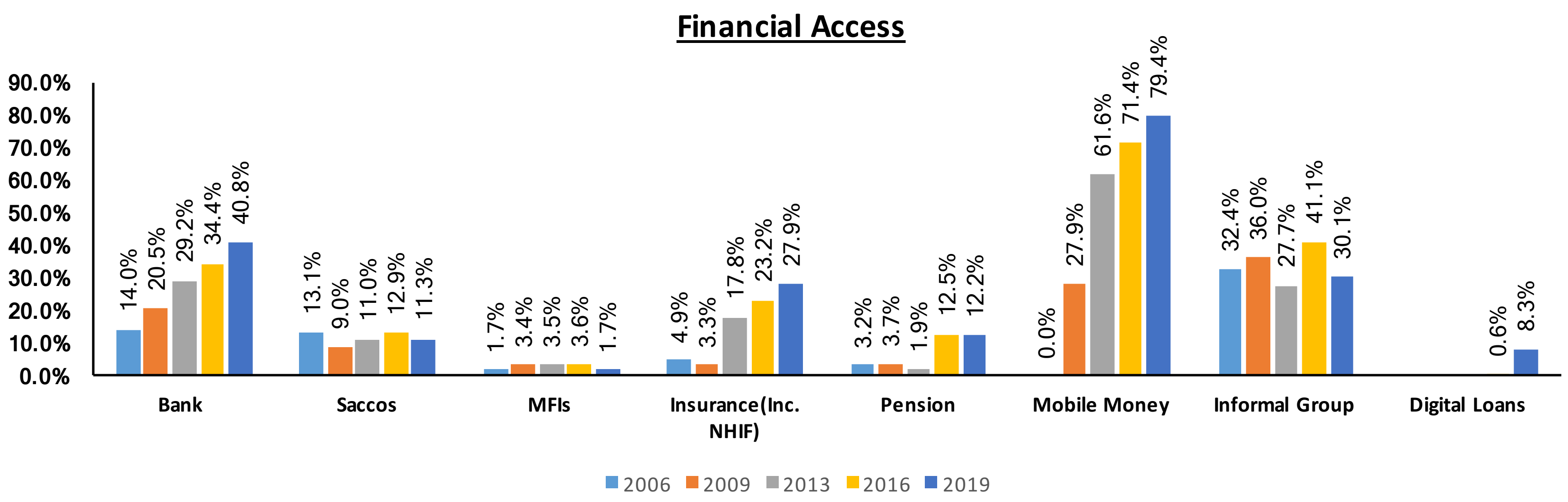
Source – CBK

III. Banking Sector Overview

Kenya 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 40 commercial banks, with Charterhouse Bank under statutory management and Imperial Bank under receivership, 1 mortgage finance company, 13 microfinance banks, 9 representative offices of foreign banks, 73 foreign exchange bureaus, 19 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) rising to be the preferred method to access financial services in 2019, with 79.4% of the adult population using the channel



Source: Central Bank of Kenya, FinAccess report

Recent Developments in the Kenyan Banking Sector

Consolidation continues in the banking sector, with the most recent being that of KCB's acquisition of National Bank of Kenya

1. **Consolidation:** Kenya's banking sector has witnessed heightened M&A activity over the last 4 years. KCB Group announced its intention to acquire 100.0% of the issued share capital of National Bank of Kenya. The proposition has been ratified with both sets of shareholders, and is awaiting regulatory approval from the Central Bank of Kenya, and the Competition Authority of Kenya. Below is a summary of key transactions done over the last five years and their transaction multiples. It is worth noting that transactions are happening at relatively cheaper multiples compared to historical levels.

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs bns)	Transaction Stake	Transaction Value (Kshs bns)	P/Bv Multiple	Date
KCB Group	National Bank of Kenya	7.0	100.0%	6.6	**0.9x**	19-Apr*
CBA Group	Jamii Bora Bank	3.4	100.0%	1.4	**0.4x**	19-Jan*
AfricInvest Azure	Prime Bank	21.2	24.2%	5.1	**1.0x**	19-Jan
CBA Group	NIC Group	33.5**	53:47***	Undisclosed	**N/A**	19-Jan*
KCB Group	Imperial Bank	Unknown	Undisclosed	Undisclosed	**N/A**	18-Dec
SBM Bank Kenya	Chase Bank ltd	Unknown	75.0%	Undisclosed	**N/A**	18-Aug
DTBK	Habib Bank Kenya	2.4	100.0%	1.8	**0.8x**	17-Mar
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	**1.6x**	16-Nov
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	**1.4x**	16-Jun
I&M Holdings	Giro Commercial Bank	3	100.0%	5	**1.7x**	16-Jun
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	**2.3x**	15-Mar
Centum	K-Rep Bank	2.1	66.0%	2.5	**1.8x**	14-Jul
GT Bank	Fina Bank Group	3.9	70.0%	8.6	**3.2x**	13-Nov
Average			**78.3%**		**1.5x**	

** Announcement date*

*** Book Value as of the announcement date*

**** Shareholder swap ratio between CBA and NIC, respectively*

Recent Developments in the Banking Sector Cont..

The Banking (Amendment) Act 2015 was termed unconstitutional by The High Court, with a proposition to repeal it being included in the Finance Bill 2019

2. Regulation

i. **Banking Sector Charter:** The Central Bank of Kenya proposed to introduce a Banking Sector Charter in 2018, which will guide service provision in the sector. The Charter which came into effect in March 2019, aims to instil discipline in the banking sector in order to make it responsive to the needs of the banked population. It is expected to facilitate a market-driven transformation of the Kenyan banking sector, thereby considerably improving the quality of service provided, as well as increase the access to affordable financial services for the unbanked and under-served population. The implementation of the charter will likely see industry-wide adoption of risk-based credit scoring, which requires banks to extend credit on the basis of their credit scores, as determined by licensed credit reference bureaus

ii. **Banking (Amendment) Act 2015:** During the quarter, the high court suspended the Banking (Amendment) Act 2015 for 1-year, terming it as unconstitutional. The court found the provisions of sections 33 b (1) and (2) of the banking act, which capped interest at 4.0% above the Central Bank Rate (CBR) to be vague, imprecise and ambiguous. Furthermore, in the Finance Bill 2019, the Cabinet Secretary of The National Treasury proposed to repeal the Act, citing that since its enactment, the law has failed to meet its objective of improved credit access, especially to MSMEs. We thus expect that increased pressure on a repeal of the rates to possibly result in a review of the law

Recent Developments in the Banking Sector Cont….

Various banks highlighted their SME-focussed lending plans, with the launch of the Stawi facility being the key highlight

3. SME-Focussed Lending:

i. The Central Bank of Kenya (CBK), in conjunction with five commercial banks (NIC Group, KCB Group, Diamond Trust Bank Kenya (DTBK), Co-operative Bank Kenya and Commercial Bank of Africa (CBA)), came up with a mobile loan facility targeting Micro Small and Medium Enterprises (MSMEs). The facility dubbed "Stawi" targets small business owners who don't have access to formal credit because of the informal nature of their businesses and lack of collateral. The amounts available to the users will range from Kshs 30,000 to Kshs 250,000, with a repayment period of between 1 – 12 months. The facility will attract an interest rate of 9.0%, per annum and other charges such as a 4.0% facilitation, a 0.7% insurance fee of the disbursed amount, and an excise duty of 20% on the facilitation fee

ii. Equity Group highlighted its plan to roll out lending focused especially on Micro, Small and Medium Enterprises (MSMEs), which operate in the agricultural, manufacturing and health sectors. The bank highlighted the plan to lend approximately Kshs 150.0 bn, with funds expected to be sourced from the maturing investments in government securities

Growth in the Banking Sector

Listed banks' Q1'2019 EPS increased by 12.2% y/y from an average increase of 14.4% witnessed in Q1'2018

- Kenya's listed banks recorded an EPS growth of 12.2% in Q1'2019, slower than the 14.4% growth recorded in Q1'2018. The performance highlights the banking sectors' continued resilience and profitability. The relatively slower performance may be attributed to a strong performance in Q1'2018, with the sector coming from a low performance base in Q1'2017
- The performance was supported by a 4.5% increase in Net Interest Income (NII) coupled with a 10.7% growth in Non-Funded Income (NFI). The Net Interest Margin (NIM) decreased to 8.0% in FY'2018 from 8.1% in FY'2017, highlighting the decline in average yields on interest earnings assets, owing to increased allocation to relatively lower yielding Government securities, and the 100 bps decline of the Central Bank Rate which effectively reduced the yields on loans
- The sector continued to record an improvement in operating efficiency as the Cost to Income Ratio (CIR) improved to 53.8% in Q1'2019, from 56.6% in Q1'2018, amid cost rationalization measure such as branch closures, staff layoffs in voluntary retirement plans and digitization strategies aimed at reducing operational costs
- Listed banks recorded an improved 7.7% growth in net loans and advances in Q1'2019, from a growth of 6.1% recorded in Q1'2018, indicating banks may have relaxed their stringent credit policies, as they focused on corporate and secured lending
- Profitability improved, as indicated by the rise in the Return on Average Equity to 19.2%, from 18.4% in Q1'2018

Banking Sector Growth Drivers

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

1) **Increased adoption of technology to improve efficiency:** Banks have been riding on the digital revolution wave to improve their operational efficiency. Increased adoption of alternative channels of transactions 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 reducing the staff required and by extension reducing operating expenses and hence improving operational efficiency
2) **Diversification to different revenue streams:** Banks have continued to diversify their revenue sources, as they adapt to operating under the interest rate cap regime. Banks increased the fees and commissions on loans and ventured into various NFI growth ventures such bancassurance, brokerage, 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) **Economic recovery:** The ongoing economic recovery albeit slow, will still lead to improved demand for credit from sectors such as agriculture, real estate, manufacturing and trading which presents interest income growth opportunities for banks as they focus on collateral-based lending

Consolidation and Diversification to drive Growth

Focus Area	Summary	Effect on Banking Sector
Regulation	• **Banking (Amendment) Act 2015:** Put in place in the industry following the enactment of the Banking Act (Amendment) 2015, with deposit floor removed in Finance Act 2018 • **Implementation of Banking Sector Charter:** enforces consumer protection and risk-based credit pricing framework	• Net Interest Margins remain compressed as downward revisions of CBR compress yields on loans • Increased quality of service provision, transition to a credit-score based lending framework, and entrenching the ethical culture in banks
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
Consolidation	• **Various Mergers and Acquisitions happening:** With increased competition amongst players in the banking sector, coupled with tough operating environment, several consolidations have happened.	• Consolidations 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	• **Increase in non-performing loans:** With the Gross NPL ratio currently at 10.4%, up from 9.6% in Q1'2018, and much higher than the 5-year average of 8.4%. This raises concerns around asset quality in the sector	• The increased NPLs and adoption of IFRS 9 has forced banks to adopt 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

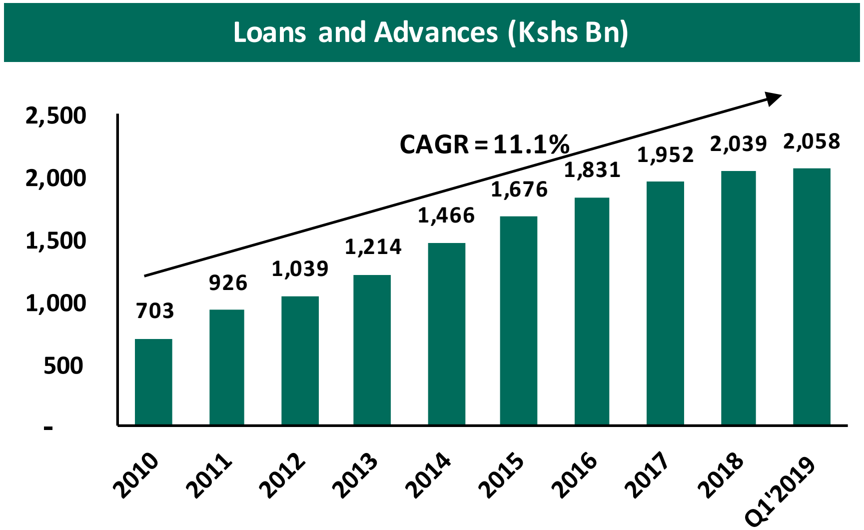
The Banking sector maintained its growth trajectory largely aided by recovery in funded income as well as a relatively stronger growth in NFI. Increased usage of alternative channels improves operational efficiency as well as expanding Non-Funded Income. Deteriorating asset quality remains a concern, which has seen banks reduce lending to the riskier private sector and instead continue channeling funds to government securities, in addition to raising their provisioning expenses

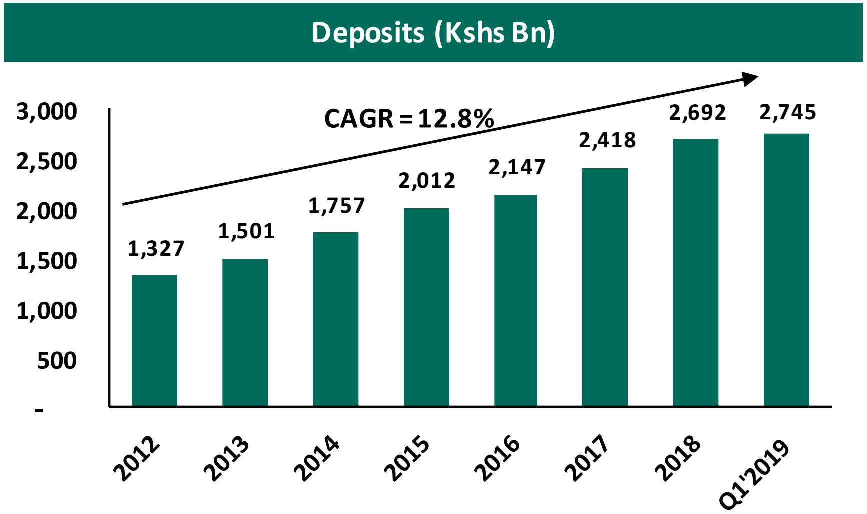
III. Listed Banking Sector Metrics

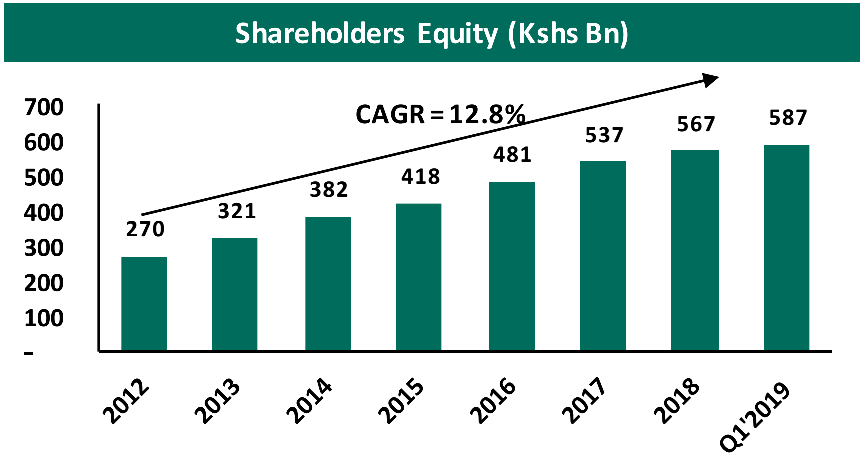
Cytonn

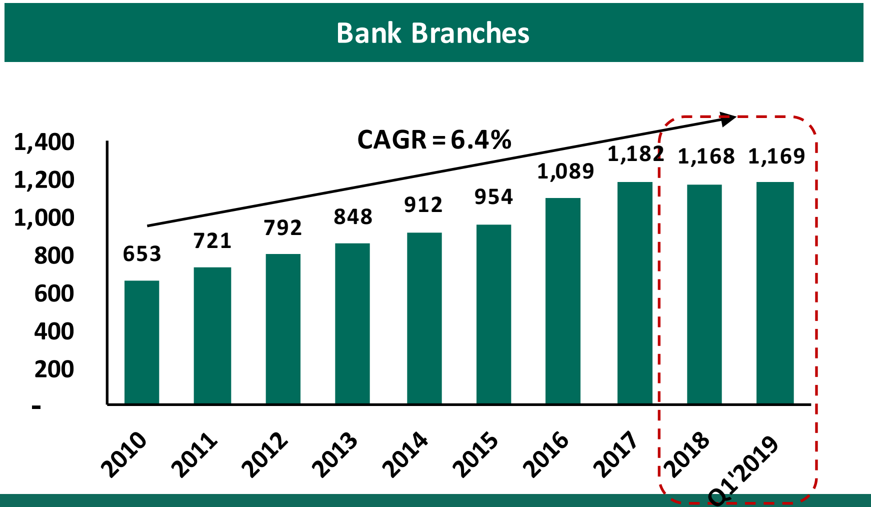
Listed Banking Sector Metrics

Deposit growth has remained strong, faster than the growth in loans and advances. The number of branches has grown slower by 6.4%, with 1 branch opened in Q1'2019





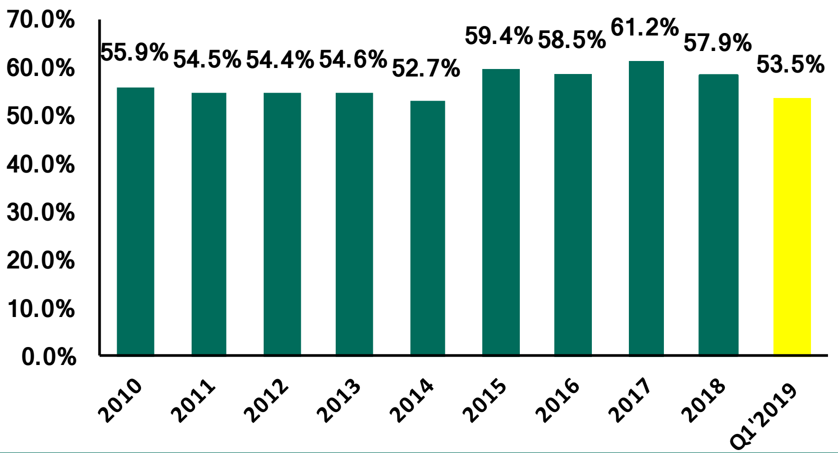




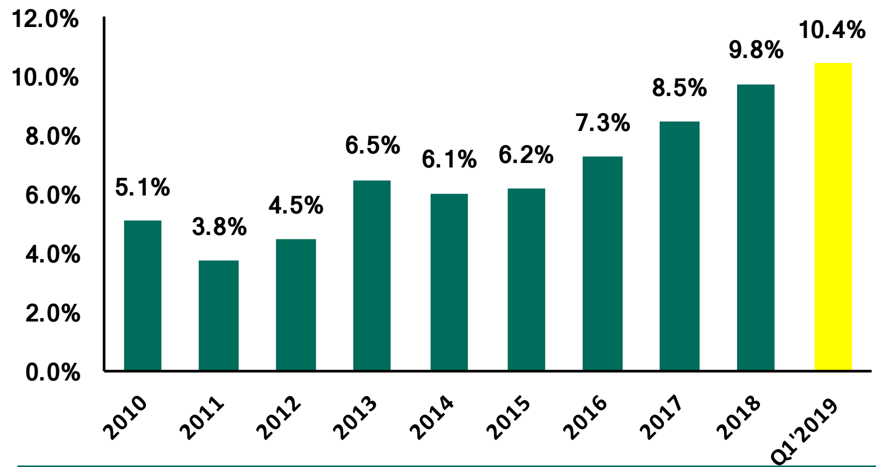
Listed Banking Sector Metrics

Under the current loan pricing framework, lending, leading remains subdued as yields continue to decline, with banks focusing on improving efficiency, growing NFI and containing asset quality deterioration

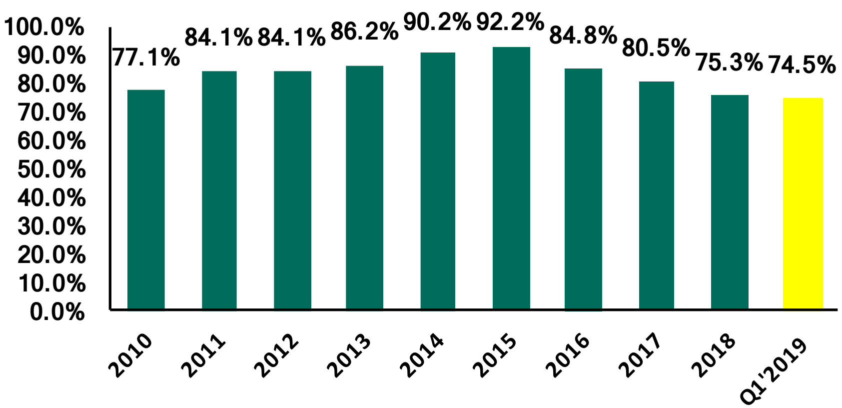
Cost to Income Ratio



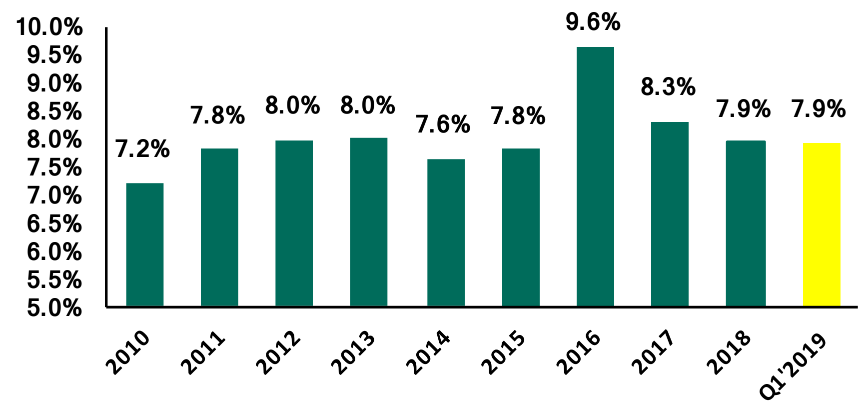
NPL Ratio



Loan to Deposit Ratio



Net Interest Margin



Listed Banking Earnings and Growth Metrics

Kenya's listed banking sector Q1'2019 core EPS increased by 12.2%, slightly slower compared to a growth of 14.4% in Q1'2018

Bank	Core EPS Growth	Net Interest Margin	NFI to Total Operating Income	Deposit Growth	Growth In Govt Securities	Loan Growth	LDR	Return on Average Equity
NBK	N/A	8.2%	22.5%	2.6%	15.1%	(10.2%)	51.5%	11.3%
SCBK	31.2%	7.8%	32.4%	0.3%	13.9%	3.3%	50.5%	18.2%
I&M Holdings	30.5%	6.6%	38.2%	28.8%	8.2%	10.6%	76.4%	17.9%
Stanbic Bank	19.3%	4.9%	48.9%	29.0%	(8.8%)	12.6%	75.9%	14.3%
Barclays Bank	13.8%	8.7%	32.2%	15.9%	24.0%	9.0%	80.6%	16.5%
KCB Group	11.4%	8.5%	32.3%	11.2%	18.9%	10.9%	84.1%	22.4%
DTBK	9.3%	6.2%	25.3%	1.3%	5.3%	(2.9%)	68.5%	13.8%
Equity Bank	4.9%	8.6%	40.8%	12.1%	13.0%	12.7%	71.3%	22.8%
Coop Bank	4.4%	8.7%	37.7%	7.4%	33.1%	(0.5%)	81.0%	18.3%
NIC Bank	(4.3%)	5.9%	29.1%	5.0%	10.3%	2.1%	78.3%	12.2%
HF Group	N/A	4.1%	33.6%	(5.3%)	45.1%	(13.9%)	89.1%*	7.8%
Q1'2019 Weighted Average**	**12.2%**	**7.9%**	**36.0%**	**11.9%**	**15.9%**	**7.8%**	**74.4%**	**19.2%**
Q1'2018 Weighted Average	**14.4%**	**8.1%**	**37.1%**	**9.4%**	**25.0%**	**6.1%**	**76.8%**	**18.4%**

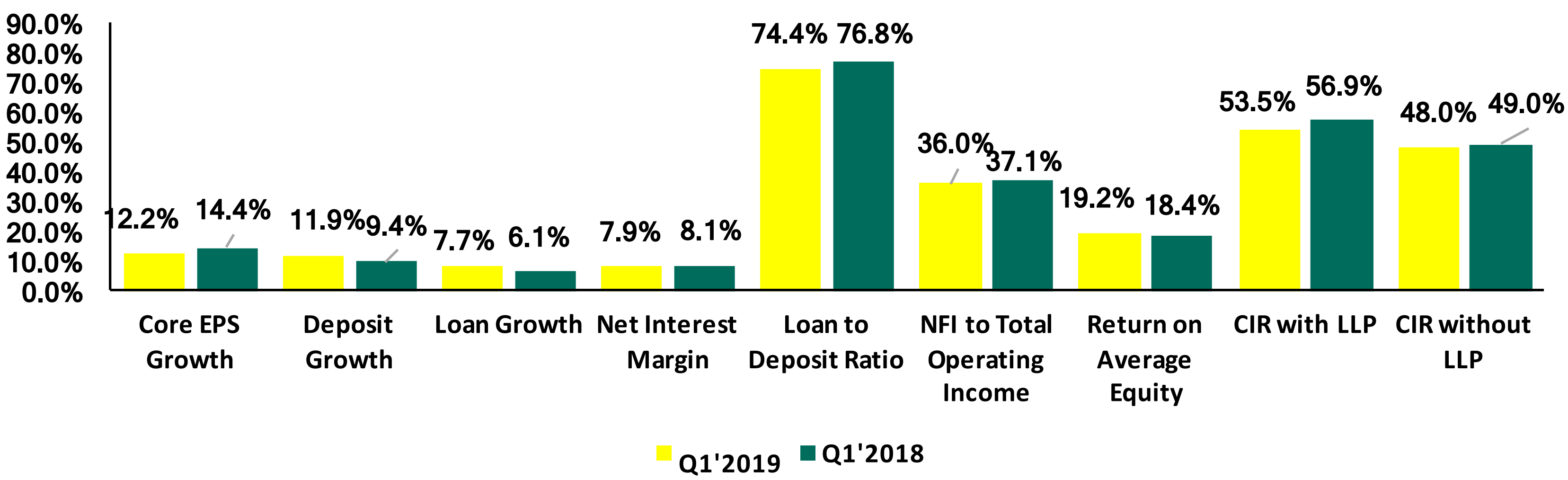
**Loans to Loanable funds used owing to nature of the business*

** *The weighted average is based on market capitalization as at 31st May 2019*

Listed Banks Earnings and Growth Metrics Cont…

Listed banks witnessed an improvement in operational efficiency, an improvement in total operating income, and consequently higher profitability

Earnings & Growth Metrics



- Credit extension remains subdued as indicated in the decline in the LDR to 74.4% from 76.8% in Q1'2018, with retaining their preference of government securities
- Increased focus on cost rationalization is bearing fruit, as operational efficiency continues to improve, as shown by the improvements in both cost to income, and cost to income without LLP
- NFI improvement and cost rationalization continue to support growth, with profitability rising as shown by the rise in return on equity

Listed Banks Operating Metrics

Non-interest Income currently contributes to 36.0% of banks total operating income, down from 37.1% in Q1'2018, owing to the recovery in NII

Bank	Deposit/Branch (bn)	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non Funded Income/Revenue
DTBK	2.0	7.3%	50.7%	14.7%	25.3%
KCB Group	2.1	7.7%	51.0%	16.0%	32.3%
Barclays Bank	2.5	8.1%	67.8%	13.1%	32.2%
Equity Bank	1.5	9.2%	45.1%	14.6%	40.8%
Coop Bank	2.1	11.1%	52.2%	16.6%	37.7%
Stanbic Bank	7.3	11.6%	56.4%	12.6%	48.9%
I&M Holdings	5.4	13.0%	57.4%	15.3%	38.2%
NIC Bank	3.6	13.9%	40.8%	16.6%	29.1%
SCBK	6.5	15.9%	76.5%	15.8%	32.4%
HF Group	1.5	27.5%	39.8%	16.0%	33.6%
NBK	1.3	48.5%	60.3%	5.7%	22.5%
Weighted Average Q1'2019*	**3.1**	**10.4%**	**54.5%**	**15.1%**	**36.0%**

**Market cap weighted average as at 31st May 2019*

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 1.2x and average P/E of 6.2x

Bank	No. of shares (bn)	Market Cap (bn)	P/E	Price*	P/TBV
HF Group	0.4	1.7	2.1x	4.4	0.2x
NBK	0.3	1.4	1.8x	4.1	0.2x
NIC Bank	0.7	21.5	5.1x	30.5	0.6x
DTBK	0.3	33.6	4.6x	120.0	0.6x
Coop Bank	5.9	73.0	5.7x	12.5	1.0x
I&M Holdings	0.8	47.1	5.2x	57.0	1.0x
KCB Group	3.1	121.1	4.9x	39.5	1.0x
Stanbic Bank	0.4	38.7	5.9x	98.0	1.1x
Barclays Bank	5.4	55.4	7.5x	10.2	1.2x
SCBK	0.3	66.3	7.6x	193.0	1.4x
Equity Bank	3.8	146.6	7.3x	38.9	1.7x
Weighted Average Q1'2019			**6.2x**		**1.2x**

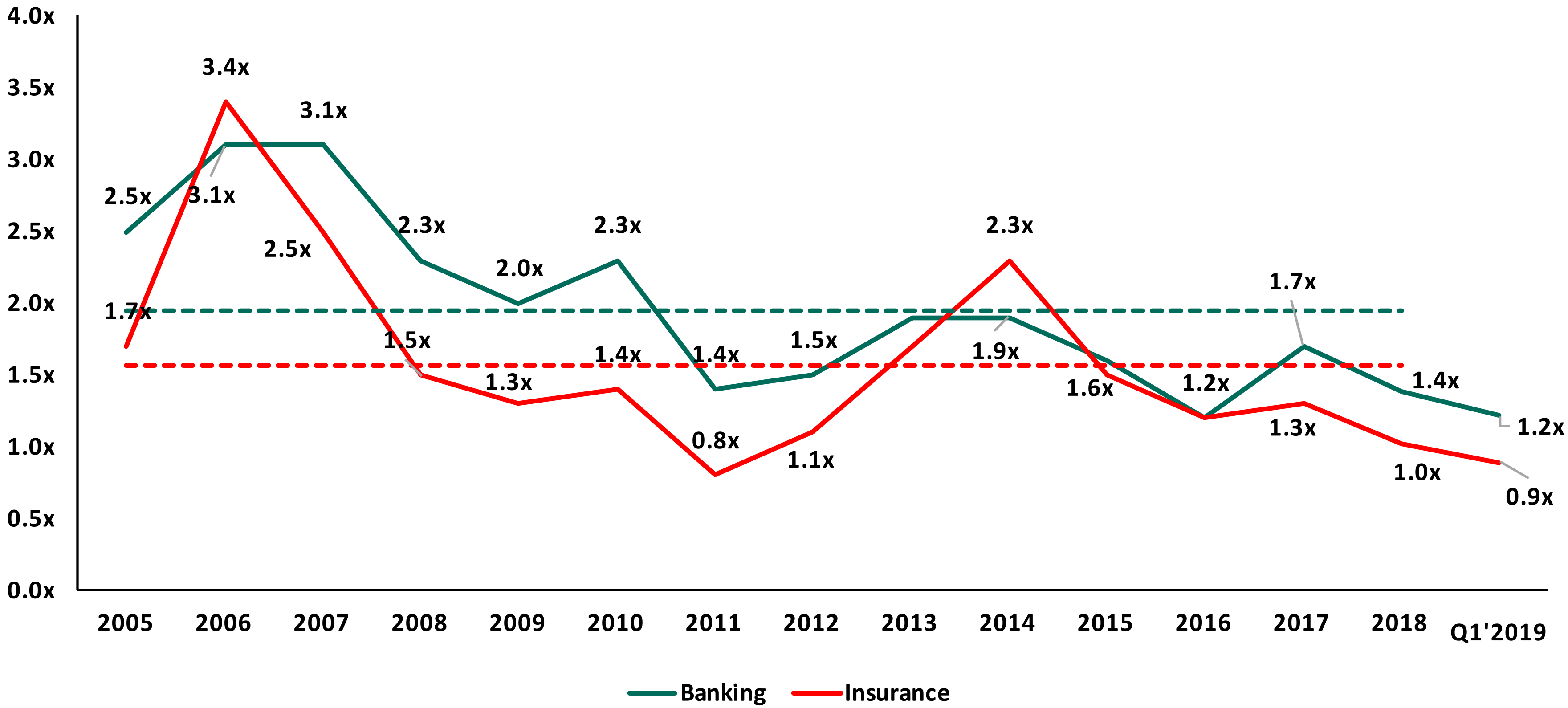
P/E calculation for HF used normalized earnings over a period of 5 years

**Prices as at 31st May 2019*

Listed Banks & Insurance Trading Metrics

Listed banks trade at an average P/B of 1.2x, higher than the insurance sector which has been priced at 0.9x. Both sectors are trading below their 14-year averages of 1.9x and 1.6x, respectively

14 year Price to Book Value: Banking and Insurance



On a price to book valuation, listed banks are currently priced at a PBV of 1.2x, higher than listed insurance companies at 0.9x, with both lower than their historical averages of 1.9x for the banking sector and 1.6x for the insurance sector

Summary of the Q1’2019 Earnings

The sector 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 12.2% in core earnings per share in Q1’2019, 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 48.0%, from 49.0% in Q1’2018
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 10.4%, from 9.6% in Q1’2018, 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
3. The sector continued to record a relatively strong balance sheet growth, as deposits grew by 11.0%, faster than loans which grew by 7.7%. Loan growth is faster than the 6.1% y/y growth recorded in Q1’2018, on higher segmented lending by banks to corporates, and secured borrowers . The loan to deposit ratio declined to 74.0% from 76.8% in Q1’2018, indicative continued reduced intermediation, with banks retaining the preference for government securities investments which rose by 16.1%

IV. Banks Valuation Reports

Cytonn

Valuation Summary of Listed Banks

Diamond Trust Bank presents the highest upside with an expected total return of 92.5%

Bank	Current Price	Target Price	Dividend Yield	Upside/(dowside)	Total return
DTBK	120.0	228.4	2.2%	90.3%	92.5%
KCB Group	39.5	60.4	8.9%	52.9%	61.9%
Co-operative Bank	11.5	17.1	8.7%	48.3%	57.1%
I&M Holdings	57.0	81.5	6.8%	43.0%	49.2%
NIC Group	30.5	42.5	4.1%	39.3%	43.5%
Equity	38.9	53.7	5.1%	38.1%	43.2%
Barclays	10.2	12.8	10.8%	25.4%	36.3%
Stanbic Holdings	99.0	113.6	5.9%	14.7%	20.6%
SCBK	193.0	200.6	9.8%	4.0%	13.9%
NBK	4.1	3.9	0.0%	(3.8%)	(3.9%)
HFCK	5.0	2.9	0.0%	(42.0%)	(42.1%)

A. Tier I Banks

I. Equity Group Holdings

Equity Group's Summary of Performance – Q1'2019

- Equity Group recorded a profit before tax growth of 6.1% to Kshs 8.8 bn, up from Kshs 8.3 bn in Q1'2018. Profit after tax grew by 4.9% to Kshs 6.2 bn in Q1'2019, from Kshs 5.9 bn in Q1'2018, with the difference in growth attributable to the marginal increase in the effective tax rate to 29.4% from 29.1% in Q1'2018
- Total operating income increased by 6.6% to Kshs 17.6 bn, from Kshs 16.5 bn in Q1'2018, driven by a 6.3% increase in Net Interest Income (NII) to Kshs 10.4 bn, from Kshs 9.8 bn in Q1'2018, coupled with a 6.9% increase in Non-Funded Income (NFI) to Kshs 7.2 bn, from Kshs 6.7 bn in Q1'2018
- Total operating expenses rose by 7.0% to Kshs 8.8 bn, from Kshs 8.2 bn in Q1'2018, largely driven by a 14.3% increase in Loan Loss Provisions (LLP) to Kshs 0.41 bn from Kshs 0.36 bn in Q1'2018, coupled with a 9.6% increase in other operating expenses to Kshs 5.7 bn from Kshs 5.2 bn in Q1'2018
- The balance sheet recorded an expansion as total assets increased by 14.8% to Kshs 605.7 bn, from Kshs 527.8 bn in Q1'2018, supported by a 12.7% increase in the loan book to Kshs 305.5 bn, from Kshs 271.1 bn, coupled with a 13.0% increase in government securities to Kshs 169.7 bn from Kshs 150.2 bn in Q1'2018,
- Asset quality deteriorated as Gross Non-Performing Loans (NPLs) increased by 62.3% to Kshs 29.4 bn in Q1'2019, from Kshs 18.1 bn in Q1'2018. The NPL ratio thus deteriorated to 9.2% in Q1'2019 from 6.5% in Q1'2018.
- Going forward, we expect the bank's growth to be driven by:
    a) Channeled diversification is likely to further improve on efficiency with emphasis on alternative channels of transactions, as the bank rides on the digital revolution wave, thereby further improving the cost to income ratio by cost rationalization and revenue expansion

Financial Statements Extracts

Equity Group's PAT is expected to grow at a 5-year CAGR of 16.0%

Income Statement	2017	2018	2019e	2020e
Net Interest Income	37.6	41.4	44.5	49.6
Non Funded Income	27.6	25.9	27.7	31.3
Loan Loss Provision	(3.4)	(3.7)	(3.7)	(4.1)
Other Operating Expenses	(34.8)	(35.1)	(37.3)	(40.9)
Total Operating Expenses	**(38.3)**	**(38.8)**	**(41.0)**	**(45.1)**
Profit Before Tax	26.9	28.5	31.2	35.8
Profit After tax	18.9	19.8	21.8	25.1
% PAT Change YoY	**14.0%**	**4.8%**	**10.0%**	**14.9%**
EPS	5.0	5.3	5.8	6.6
DPS	2.0	2.0	2.0	2.0
Cost to Income	58.7%	57.7%	56.9%	55.7%
NIM	8.9%	8.5%	8.5%	8.4%
ROaE	21.6%	22.5%	22.2%	22.5%
ROaA	3.8%	3.8%	3.6%	3.6%

Balance Sheet	2017	2018e	2019e	2020e
Net Loans and Advances	279.1	297.2	326.1	364.6
Government Securities	128.0	130.4	155.5	173.7
Other Assets	117.4	145.7	170.8	183.1
Total Assets	**524.5**	**573.4**	**652.4**	**721.4**
Customer Deposits	373.1	422.8	465.9	517.2
Other Liabilities	58.2	55.7	82.9	83.2
Total Liabilities	**431.3**	**478.4**	**548.8**	**600.4**
Shareholders Equity	93.1	94.1	102.6	120.1
Book value Per share	24.7	24.9	27.2	30.8
% Change in BPS YoY	**13.6%**	**1.0%**	**9.1%**	**16.1%**

Valuation Summary

Equity Group is undervalued with a potential upside of 43.2%

Cost of Equity Assumptions:	19-Apr-19
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.90
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.0%
Cost of Equity	21.0%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	22.3%
Return on Average Equity 2023	21.4%
Justified Price to Book value per share	2.0x
Shareholder Equity - FY23e	194.4
Terminal Value-(Year 2023)	412.30

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intergrated DDM	68.4	40.0%	27.3
Residual Income	56.6	35.0%	19.8
PBV Multiple	24.7	20.0%	4.9
PE Multiple	32.3	5.0%	1.6
Fair Value			**53.7**
Current Price			**38.9**
Upside/(Downside)			38.0%
Dividend Yield			5.1%
Total Potential Return			**43.2%**

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

II. KCB Group

Cytonn

KCB Group Summary of Performance – Q1’2019

- Profit before tax increased by 13.5% to Kshs 8.5 bn, up from Kshs 7.5 bn in Q1’2018. Profit after tax grew by 11.4% to Kshs 5.8 bn in Q1’2019, from Kshs 5.2 bn in Q1’2018
- Total operating income increased by 10.6% to Kshs 18.8 bn from Kshs 17.0 bn in Q1’2018. This was due to an 11.2% increase in Net Interest Income (NII) to Kshs 12.7 bn from Kshs 11.4 bn in Q1’2018, coupled with the 9.2% increase in Non-Funded Income (NFI) to Kshs 6.0 bn, from Kshs 5.5 bn in Q1’2018,
- Total operating expenses increased by 8.2% to Kshs 10.3 bn, from Kshs 9.5 bn, largely driven by a 93.8% rise in Loan Loss Provisions (LLP) to Kshs 1.2 bn in Q1’2019, from Kshs 0.6 bn in Q1’2018, coupled with a 4.1% rise in staff costs to Kshs 4.6 bn in Q1’2019, from Kshs 4.5 bn in Q1’2018
- The balance sheet recorded an expansion as total assets increased by 12.1% to Kshs 725.7 bn, from Kshs 647.5 bn in Q1’2018.
- The bank’s asset quality improved, with the NPL ratio improving to 8.0% from 9.9% in Q1’2018. The improved NPL ratio was mainly attributed to an improvement in the corporate loan book’s NPL ratio to 10.5% in Q1’2019 from in 14.8% in Q1’2018, as well as the SME and Micro loan book, which improved to 15.6% in Q1’2019, down from 16.3% in Q1’2018, respectively.
- Going forward, we expect the bank’s growth to be driven by:
    a) Increased Channel 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, which led to lower staff cost demands

Financial Statements Extracts

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

Income Statement	2017	2018	2019f	2020F
Net Interest Income	48.4	48.8	55.7	60.9
Non Funded Income	23.0	23.0	25.7	27.3
Total Operating Income	71.4	71.8	81.4	88.3
Loan Loss Provision	5.9	2.9	4.8	5.1
Other Operating Expenses	36.4	35.0	38.7	41.0
Total Operating Expenses	**42.3**	**37.9**	**43.4**	**46.1**
Profit Before Tax	29.1	33.9	38.0	42.2
Profit After tax	19.7	24.0	26.6	29.5
% PAT Change YoY	**(0.1%)**	**21.8%**	**10.7%**	**11.1%**
EPS	6.3	7.7	8.6	9.5
DPS	3.0	3.5	4.0	4.6
Cost to Income	59.2%	52.8%	53.4%	52.2%
ROE	19.5%	21.9%	22.0%	21.8%
ROA	3.2%	3.6%	3.7%	4.0%

Balance Sheet	2017	2018	2019f	2020f
Net Loans and Advances	422.7	455.9	494.8	529.7
Government Securities	110.0	120.1	129.6	140.8
Total Assets	**646.7**	**714.3**	**777.1**	**836.6**
Customer Deposits	499.5	537.5	590.4	633.5
Total Liabilities	**540.7**	**600.7**	**649.3**	**693.5**
Shareholders Equity	**106.0**	**113.7**	**127.7**	**143.1**
Book value Per share	34.1	36.6	41.1	46.1
% Change in BPS YoY	**9.7%**	**7.3%**	**12.4%**	**12.0%**

Valuation Summary

KCB Group is undervalued with a total potential return of 61.9%

Cost of Equity Assumptions:	14/06/2019
Default Spread Adjusted Risk free rate	13.2%
Beta	0.9
Market Risk Premium	7.6%
Cost of Equity	20.1%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.8%
Return on Average Equity 2023	20.6%
Justified Price to Book value per share	1.4x
Shareholder Equity - FY23e	196.3
Terminal Value - (Year 2023)	297.7

Valuation Summary	Implied Price	Weighting	Weighted Value
Residual Income	64.5	35%	22.6
PBV Multiple	44.9	20%	9.0
PE Multiple	52.5	5%	2.6
DDM Integrated	65.6	40%	26.3
Target Price			**60.4**
Current Price			**39.5**
Upside/(Downside)			53.0%
Dividend Yield			8.9%
Total Return			**61.9%**

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

III. Co-operative Bank

Cytonn

Co-operative Bank's Summary of Performance – Q1'2019

- Co-operative Bank recorded a profit before tax increase by 4.4% to Kshs 5.1 bn, up from Kshs 4.9 bn in Q1'2018. Profit after tax grew by 4.4% to Kshs 3.6 bn in Q1'2019, from Kshs 3.4 bn in Q1'2018
- Total operating income increased by 1.7% to Kshs 11.1 bn, from Kshs 10.9 bn in Q1'2018, driven by a 19.1% increase in Non-Funded Income (NFI) to Kshs 4.2 bn, from Kshs 3.5 bn in Q1'2018, which offset the 6.5% decline in Net Interest Income (NII) to Kshs 6.9 bn, from Kshs 7.4 bn in Q1'2018,
- Total operating expenses declined by 1.2% to Kshs 6.0 bn, from Kshs 6.1 bn in Q1'2018, largely driven by the 34.3% decrease in Loan Loss Provisions (LLP) to Kshs 0.5 bn, from Kshs 0.8 bn in Q1'2018,
- The balance sheet recorded an expansion as total assets increased by 7.0% to Kshs 425.7 bn, from Kshs 397.8 bn in Q1'2018, supported by a 33.1% growth in government securities to Kshs 103.9 bn, from Kshs 78.1 bn,
- The bank's asset quality deteriorated, with the NPL ratio deteriorating to 11.1%, from 10.9% in Q1'2018. The main sectors that contributed to the NPLs were manufacturing, agriculture, trade, and building & construction,

Going forward, we expect the bank's growth to be driven by:

a) **Focus on diversification:** The bank's continued focus on channel diversification will likely continue to help the bank in generating profitability, as they continue to record increased usage and traffic. The focus on branch transformation and innovation centered on alternative channels will continue to drive NFI growth as well as transform braches to handle advisory, wealth management and advisory services,

b) **Enhanced Credit Management:** The bank continues to manage its loan portfolio through, cherry-picking of loan issuances, proactive debt management such as loan due reminders, enhancement of systems, processes and tooling to support credit management mainly loan origination process, and sustained collections. This could help the bank manage its asset quality, which has been pressured by the relatively tougher economic environment, and,

Financial Statements Extracts

Co-operative Bank's PAT is expected to grow at a 5-year CAGR of 10.0%

Income Statement	2017	2018	2019	2020
Net Interest Income	28.1	30.8	33.3	35.7
Non Funded Income	13.5	12.9	14.1	15.6
Loan Loss Provision	3.6	1.8	3.1	3.3
Other Operating Expenses	21.7	23.9	24.4	26.7
Total Operating Expenses	25.3	25.7	27.5	30.0
Profit Before Tax	16.4	18.2	20.1	21.5
Profit After tax	11.4	12.7	14.0	15.1
% PAT Change YoY	**-10.0%**	**11.6%**	**10.2%**	**7.3%**
EPS	2.3	2.6	2.9	3.1
DPS	1.0	1.2	1.2	1.2
Cost to Income	60.9%	58.8%	58.1%	58.4%
NIM	8.8%	9.5%	9.2%	9.3%
ROE	17.4%	18.3%	18.3%	17.0%
ROA	3.1%	3.3%	3.2%	3.2%
Balance Sheet	**2017**	**2018**	**2019f**	**2020f**
Net Loans and Advances	253.9	245.4	268.4	279.1
Government Securities	44.0	49.7	54.4	57.0
Other Assets	89.0	118.3	136.8	149.8
Total Assets	**386.9**	**413.4**	**459.6**	**485.8**
Customer Deposits	287.4	306.1	337.9	354.8
Other Liabilities	29.2	36.1	36.4	36.6
Total Liabilities	**316.6**	**342.2**	**374.3**	**391.4**
Shareholders Equity	69.6	69.9	83.9	93.1
Book value Per share	14.2	14.3	17.2	19.0

Valuation Summary

Co-op Bank is undervalued with a potential upside of 57.1%

Cost of Equity Assumptions:	4/19/2019
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.9
Mature Market Risk Premium	7.6%
Extra Risk Premium	0.9%
Cost of Equity	20.9%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	21.7%
Return on Average Equity 2023	15.5%
Terminal Price to Book value per share	1.5x
Shareholder Equity - FY23e	122.82
Terminal Value-(Year 2023)	192.8

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	19.77	40%	7.91
Residual income	15.89	35%	5.56
PBV Multiple	14.44	20%	2.89
PE Multiple	14.03	5%	0.70
Target Price			**17.1**
Current Price			**11.5**
Upside/(Downside)			48.4%
Dividend Yield			8.7%
Total Return			**57.1%**

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

IV. NIC Group

Cytonn

NIC Group Summary of Performance – Q1'2019

- Profit before tax decreased by 3.7% to Kshs 1.3 bn, up from Kshs 1.4 bn in Q1'2018. Profit after tax declined by 4.3% to Kshs 0.9 bn in Q1'2019, from Kshs 1.0 bn in Q1'2018
- Total operating income rose by 8.8% to Kshs 3.8 bn, from Kshs 3.5 bn in Q1'2018 driven by a 9.4% increase in Net Interest Income (NII) to Kshs 2.7 bn, from Kshs 2.5 bn in Q1'2018, coupled with a 7.2% increase in Non-Funded Income (NFI) to Kshs 1.1 bn, from Kshs 1.0 bn in Q1'2018
- Total operating expenses rose by 16.8% to Kshs 2.5 bn, from Kshs 2.1 bn in Q1'2018, largely driven by a 21.4% increase in Loan Loss Provisions (LLP) to Kshs 0.7 bn from Kshs 0.6 bn in Q1'2018, coupled with an 11.5% increase in staff costs to Kshs 0.9 bn, from Kshs 0.8 bn in Q1'2018, and a 19.1% increase in other operating expenses to Kshs 0.9 bn, from Kshs 0.8 bn in Q1'2018
- The balance sheet recorded an expansion as total assets increased by 6.9% to Kshs 213.6 bn, from Kshs 199.8 bn in Q1'2018.
- Going forward, we expect the bank's growth to be driven by:
    a) The merger with CBA will likely enable NIC mobilize cheaper funding, leveraging on the scale and market reach of the combined entity as well as the digital channels. We expect this to help widen NIC's increase NIC's interest margins, thereby helping grow the interest income segment. Furthermore, alternative channels would aid in NFI expansion, which should aid in generating higher profitability

NIC/CBA Merged Financial Statements

NIC Group's PAT is expected to grow at a 5-year CAGR of 11.8%

Income Statement	2017	2018	2019f	2020f
Net Interest Income	20.4	20.3	22.3	25.6
Non Funded Income	14.6	16.1	17.0	18.6
Loan Loss Provision	6.0	6.1	6.3	6.7
Total Operating Expenses	22.7	24.1	25.0	27.4
Profit Before Tax	12.4	12.3	14.2	16.8
Profit After tax	8.2	8.9	10.0	11.8
% PAT Change YoY		**9.3%**	**11.3%**	**18.0%**
EPS	12.8	14.0	15.6	18.4
DPS	1.0	0.0	1.1	1.1
Cost to Income	64.7%	66.3%	63.8%	62.0%
NIM	5.6%	5.2%	5.4%	5.8%
ROE	13.6%	13.7%	14.1%	14.5%
ROA	1.9%	2.0%	2.1%	2.3%

Balance Sheet	2017	2018	2019f	2020f
Net Loans and Advances	233.4	239.6	258.2	280.8
Government Securities	120.2	129.7	141.1	153.2
Other Assets	98.3	84.3	81.8	93.7
Total Assets	**452.0**	**453.6**	**481.1**	**527.7**
Customer Deposits	332.7	341.0	363.7	392.8
Other Liabilities	54.4	46.2	41.8	48.3
Total Liabilities	**387.1**	**387.2**	**405.5**	**441.0**
Shareholders Equity	64.4	66.0	75.3	86.3
Book value Per share	7.19	7.37	8.41	9.64
% Change in BVPS	**14.8%**	**2.5%**	**14.0%**	**14.7%**

Valuation Summary

NIC Group is undervalued with a total potential return of 43.5%

Cost of Equity Assumptions:	
Default Spread Adjusted Risk free rate	13.20%
Beta	1.00
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.0%
Cost of Equity	21.8%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	21.8%
Return on Average Equity 2023	13.0%
Terminal Price to Book	0.9x
Shareholder Equity - FY23e	116.0
Terminal Value-(Year 2023)	110.8

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	48.8	40%	19.5
Residual Valuation	32.5	35%	11.4
PBV Multiple	48.8	20%	9.8
PE Multiple	37.4	5%	1.9
Target Price			**42.5**
Current Price			**30.5**
Upside/(Downside)			39.4%
Dividend Yield			4.1%
Total Potential Return			**43.5%**

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

V. Standard Chartered Bank Kenya

SCBK's Summary of Performance – Q1'2019

- Profit before tax increased by 27.8% to Kshs 3.5 bn, from Kshs 2.8 bn in Q1'2018. Profit after tax grew by 31.2% to Kshs 2.4 bn in Q1'2019, from Kshs 1.8 bn in Q1'2018
- Total operating income increased by 3.7% to Kshs 7.4 bn from Kshs 7.1 bn in Q1'2018. The rise was due to a 5.6% increase in Non-Funded Income(NFI) to Kshs 2.4 bn from Kshs 2.3 bn in Q1'2018, coupled with a 2.8% increase in Net Interest Income (NII) to Kshs 5.0 bn, from Kshs 4.8 bn in Q1'2018
- Total operating expenses declined by 11.8% to Kshs 3.8 bn, from Kshs 4.3 bn, largely driven by a 61.0% decline in loan loss provisions to Kshs 415.1 mn, from Kshs 1.1 bn in Q1'2018. The large decline in loan loss provisions was however mitigated by a 14.3% rise in staff costs to Kshs 1.8 bn, from Kshs 1.6 bn in Q1'2018
- The balance sheet recorded an expansion as total assets increased by 2.5% to Kshs 301.4 bn, from Kshs 294.0 bn in Q1'2018.
- The bank's asset quality deteriorated, with the NPL ratio rising to 15.9% from 14.0% in Q1'2018. The deteriorating NPL ratio is attributable to a 19.2% rise in gross non-performing loans to Kshs 21.2 bn from Kshs 17.8 bn in Q1'2018 due to recovery problems of loans made to key troubled sectors such as real estate and manufacturing
- Going forward, we expect the bank's growth to be driven by:
    a) 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 Q1'2019 as evidenced by the worsening of the cost to income ratio to 46.3% from 46.0% in Q1'2018. Revenue expansion coupled with cost containment will be key in boosting the bank's bottom line.

Financial Statements Extracts

SCBK's PAT is expected to grow at a 5-year CAGR of 10.8%

Income Statement	2017	2018	2019f	2020F
Net Interest Income	48.4	48.8	55.7	60.9
Non Funded Income	23.0	23.0	25.7	27.3
Total Operating Income	71.4	71.8	81.4	88.3
Loan Loss Provision	5.9	2.9	4.8	5.1
Other Operating Expenses	36.4	35.0	38.7	41.0
Total Operating Expenses	**42.3**	**37.9**	**43.4**	**46.1**
Profit Before Tax	29.1	33.9	38.0	42.2
Profit After tax	19.7	24.0	26.6	29.5
% PAT Change YoY	**(0.1%)**	**21.8%**	**10.7%**	**11.1%**
EPS	6.3	7.7	8.6	9.5
DPS	3.0	3.5	4.0	4.6
Cost to Income	59.2%	52.8%	53.4%	52.2%
ROE	19.5%	21.9%	22.0%	21.8%
ROA	3.2%	3.6%	3.7%	4.0%

Balance Sheet	2017	2018	2019f	2020f
Net Loans and Advances	422.7	455.9	494.8	529.7
Government Securities	110.0	120.1	129.6	140.8
Total Assets	**646.7**	**714.3**	**777.1**	**836.6**
Customer Deposits	499.5	537.5	590.4	633.5
Total Liabilities	**540.7**	**600.7**	**649.3**	**693.5**
Shareholders Equity	**106.0**	**113.7**	**127.7**	**143.1**
Book value Per share	34.1	36.6	41.1	46.1
% Change in BPS YoY	**9.7%**	**7.3%**	**12.4%**	**12.0%**

Valuation Summary

SCBK is undervalued with a total potential total return of 13.9%

Cost of Equity Assumptions:	14-Jun-19
Default Spread Adjusted Risk free rate	13.3%
Beta	0.8
Mature Market Risk Premium	7.6%
Extra Risk Premium	0.0%
Cost of Equity	19.4%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	20.9%
Return on Average Equity 2023	21.6%
Justified Price to Book value per share	1.7x
Shareholder Equity - FY23e	60.3
Terminal Value-(Year 2023)	109.8

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	218.53	40%	87.41
Residual Income	213.78	35%	74.82
PBV Multiple	154.60	20%	30.92
PE Multiple	151.64	5%	7.58
Target Price			**200.7**
Current Price			**193.0**
Upside/(Downside)			4.0%
Dividend Yield			9.8%
Total Return			**13.9%**

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

VI. Diamond Trust Bank Kenya

DTBK’s Summary of Performance – Q1’2019

- DTBK recorded a profit before tax increase of 7.8% to Kshs 2.9 bn, up from Kshs 2.7 bn in Q1’2018. Profit after tax grew by 9.3% to Kshs 2.0 bn in Q1’2019, from Kshs 1.8 bn in Q1’2018
- Total operating income declined by 1.9% to Kshs 6.1 bn, from Kshs 6.2 bn in Q1’2018, occasioned by the 6.6% decline in Net Interest Income (NII) to Kshs 4.5 bn, from Kshs 4.9 bn in Q1’2018, which offset the 15.3% increase in Non-Funded Income (NFI) to Kshs 1.5 bn, from Kshs 1.3 bn in Q1’2018
- Total operating expenses declined by 9.7% to Kshs 3.2 bn, from Kshs 3.5 bn, largely driven by the 61.5% decline in Loan Loss Provisions (LLP) to Kshs 0.3 bn in Q1’2019, from Kshs 0.7 bn in Q1’2018, which offset the 5.4% rise in staff costs to Kshs 1.1 bn in Q1’2019, from Kshs 1.0 bn in Q1’2018
- The balance sheet recorded an expansion, albeit marginal, as total assets increased by 0.7% to Kshs 370.1 bn, from Kshs 367.7 bn in Q1’2018. This growth was largely driven by a 5.3% increase in investments in government and other securities to Kshs 125.7 bn, from Kshs 119.4 bn in Q1’2018, coupled with a 48.8% increase in other assets to Kshs 12.9 bn, from Kshs 8.7 bn in Q1’2018, which outweighed the 2.9% decline in the loan book to Ksh 188.6 bn, from Kshs 194.1 bn in Q1’2018
- The bank experienced an improvement in its asset quality as the gross Non-Performing Loans (NPLs) declined by 6.7% to Kshs 14.4 bn in Q1’2019 from Kshs 15.4 bn in Q1’2018, and consequently, the NPL ratio improved to 7.3%, from 7.5% in Q1’2018

Going forward, we expect the DTBK’s growth to be driven by:

Geographical diversification: DTBK’s increased focus on other regions will boost the growth in the bottom line, supported by the expansion of funded income which has remained subdued due to the pricing restriction existent in Kenya. A diversification into other regions would aid the bank in mitigating the sustained effects of compressed margins

Financial Statements Extracts

DTBK's PAT is expected to grow at a 5-year CAGR of 8.0%

Income Statement	2016	2017	2018f	2019f	2020f
Net Interest Income	19.4	19.7	20.0	19.7	20.5
Non Funded Income	5.1	5.3	5.4	5.6	4.8
Loan Loss Provision	4.3	4.3	3.0	2.1	2.2
Other Operating Expenses	5.8	6.6	7.3	7.1	7.1
Total Operating Expenses	**13.5**	**14.9**	**14.5**	**13.7**	**14.0**
Profit Before Tax	11.0	10.1	11.0	11.6	11.3
Profit After tax	7.7	6.9	7.1	7.9	7.7
% PAT Change YoY	**17.0%**	**-10.3%**	**2.3%**	**11.7%**	**-3.1%**
EPS	27.6	24.8	23.9	27.8	26.9
DPS	2.6	2.6	2.6	3.0	2.9
Cost to Income	55.1%	59.6%	56.9%	54.0%	55.5%
ROE	20.5%	13.0%	13.9%	13.5%	11.6%
ROA	2.6%	2.0%	1.9%	2.0%	1.8%
Balance Sheet	**2016**	**2017**	**2018f**	**2019f**	**2020f**
Net Loans and Advances	186.3	196.0	193.1	197.3	209.9
Government Securities	92.8	112.5	115.0	120.9	123.6
Other Assets	49.0	54.7	69.6	75.4	87.2
Total Assets	**328.0**	**363.3**	**377.7**	**393.6**	**420.7**
Customer Deposits	238.1	266.2	282.9	287.9	308.1
Other Liabilities	44.1	43.4	35.9	38.9	39.2
Total Liabilities	**282.2**	**309.7**	**318.8**	**326.8**	**347.2**
Shareholders Equity	41.0	48.4	53.7	61.4	68.1
Book value Per share	146.7	173.0	191.9	219.6	243.6
% Change in BPS YoY	**14.5%**	**17.9%**	**10.9%**	**14.4%**	**10.9%**

Valuation Summary

DTBK is undervalued with a potential upside of 92.5%

Cost of Equity Assumptions:	19-Apr-19
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.90
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.0%
Cost of Equity	21.0%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	21.8%
Return on Average Equity 2023	21.9%
Terminal Price to Book value per share	2.0x
Shareholder Equity - FY23e	211.60
Terminal Value-(Year 2023)	448.80

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	258.3	40.0%	103.3
Residual Income	191.3	35.0%	66.9
PBV Multiple	248.2	20.0%	49.6
PE Multiple	171.0	5.0%	8.6
Target Price			**228.5**
Current Price			**120.0**
Upside/(Downside)			90.4%
Dividend yield			2.2%
Total return			**92.5%**

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

VII. Barclays Bank of Kenya

Barclays Bank's Summary of Performance – Q1'2019

- Barclays Bank recorded a profit before tax growth of 2.7% to Kshs 2.8 bn, up from Kshs 2.7 bn in Q1'2018. Profit after tax grew by 0.9% to Kshs 1.90 bn in Q1'2019, from Kshs 1.88 bn in Q1'2018
- Total operating income rose by 3.1% to Kshs 8.0 bn, from Kshs 7.7 bn in Q1'2018, driven by the 14.0% growth in Non-Funded Income (NFI) to Kshs 2.6 bn, from Kshs 2.3 bn in Q1'2018, which offset the 1.3% decline in Net Interest Income (NII) to Kshs 5.4 bn, from Kshs 5.5 bn in Q1'2018
- Total operating expenses declined by 1.5% to Kshs 4.9 bn, from Kshs 5.0 bn, largely driven by the 15.2% decline in staff costs to Kshs 2.3 bn in Q1'2019, from Kshs 2.8 bn in Q1'2018
- The balance sheet recorded an expansion as total assets increased by 18.8% to Kshs 345.4 bn, from Kshs 290.7 bn in Q1'2018. This growth was largely driven by a 24.0% increase in investments in securities to Kshs 83.2 bn, from Kshs 67.0 bn in Q1'2018, coupled with a 41.8% increase in other assets to Kshs 54.0 bn, from Kshs 38.1 bn in Q1'2018
- Asset quality continued to experience a deterioration, as highlighted by the rise in the NPL ratio to 8.1% from 7.2% in Q1'2018. Main sectors experiencing challenges were trade, manufacturing and retail. The additional provisioning expenses weighed down on the improved efficiency
- Going forward, we expect the bank's growth to be driven by:
    a) **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 an accelerated growth, and consequently higher Non-Interest Revenue. This, coupled with the expansion of its agent banking network and product offerings such as banc assurance and fixed income trading will see the bank expand its topline revenue, going forward.

Financial Statements Extracts

Barclays Bank's PAT is expected to grow at a 5-year CAGR of 8.0%

Income Statement	2017	2018	2019f	2020f
Net Interest Income	21.8	22.0	23.5	24.2
Non Funded Income	8.5	9.7	10.4	11.7
Total Operating Income	**30.3**	**31.7**	**33.9**	**35.9**
Loan Loss Provision	(3.1)	(3.9)	(4.0)	(4.3)
Other Operating Expenses	(16.8)	(17.2)	(18.6)	(19.4)
Total Operating Expenses	**(19.9)**	**(21.0)**	**(22.6)**	**(23.7)**
Profit Before Tax	10.4	10.6	11.1	12.2
Profit After tax	**6.9**	**7.4**	**7.8**	**8.5**
% PAT Change YoY	**-6.4%**	**7.1%**	**4.6%**	**9.9%**
EPS	1.3	1.4	1.4	1.6
DPS	1.0	1.1	1.1	1.3
Cost to Income	65.8%	66.4%	66.6%	66.1%
NIM	9.7%	8.6%	8.5%	8.6%
ROaE	16.0%	16.8%	16.1%	17.1%
ROaA	2.7%	2.7%	2.5%	2.7%

Balance Sheet	2017	2018	2019f	2020f
Net Loans and Advances	168.4	177.4	186.8	203.0
Government Securities	58.5	92.9	79.6	83.4
Other Assets	44.3	54.5	90.1	90.6
Total Assets	**271.2**	**324.8**	**356.4**	**377.0**
Customer Deposits	186.0	207.4	230.6	249.1
Other Liabilities	41.1	73.2	73.9	74.4
Total Liabilities	**227.1**	**280.6**	**304.5**	**323.4**
Shareholders Equity	44.1	44.2	52.0	53.7
Book value Per share	**8.1**	**8.1**	**9.6**	**9.9**

Valuation Summary

Barclays Bank is undervalued with a potential upside of 36.3%

Cost of Equity Assumptions:	19-Apr-19
Default Spread Adjusted Risk free rate	13.2%
Beta	0.90
Mature Market Risk Premium	7.6%
Extra Risk Premium	0.0%
Cost of Equity	19.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	100.0%
Terminal Cost of Equity	20.8%
Return on Average Equity 2022	20.0%
Terminal Price to Book value per share	1.6x
Shareholder Equity - FY23e	60.6
Terminal Value-(Year 2021)	104.8

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	13.3	40%	5.3
Residual Income	14.7	35%	5.2
PBV Multiple	9.6	20%	1.9
PE Multiple	8.3	5%	0.4
Target Price		12.8	
Current Price		10.2	
Upside/(Downside)			25.5%
Dividend Yield			10.8%
Total Return			***36.3%***

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

VIII. Stanbic Holdings

Stanbic Bank Summary of Performance – Q1’2019

- Stanbic Bank recorded a profit after tax growth of 19.3% to Kshs 2.3 bn in Q1’2019, from Kshs 1.9 bn in Q1’2018. The performance was largely driven by an 18.5% increase in total operating income, despite the 24.4% increase in the total operating expenses
- Total operating income increased by 18.5% to Kshs 6.7 bn, from Kshs 5.7 bn in Q1’2018, driven by a 19.3% increase in Net Interest Income (NII) to Kshs 3.4 bn in Q1’2019, from Kshs 2.9 bn in Q1'2018, coupled with a 17.7% increase in Non-Funded Income to Kshs 3.3 bn, from Kshs 2.8 bn in Q1’2018
- Total operating expenses rose by 24.4% to Kshs 3.5 bn, from Kshs 2.9 bn in Q1’2018, largely driven by an 895.5% increase in the Loan Loss Provision (LLP) to Kshs 0.6 bn, from Kshs 63.4 mn in Q1’2018, as the bank increased its provisioning owing to the 61.1% increase in Non-Performing Loans (NPLs)
- The balance sheet recorded an expansion as total assets increased by 14.4% to Kshs 284.9 bn, from Kshs 249.0 bn in Q1’2018. This growth was largely driven by a 12.6% increase in the loan book to Kshs 144.7 bn from Kshs 128.5 bn
- The bank experienced a deterioration in asset quality, as Gross non-performing loans increased by 61.1% to Kshs 16.7 bn from Kshs 10.4 bn in Q1’2018. Consequently, the NPL ratio deteriorated to 10.9% from 7.8% in Q1’2018
- Going forward, we expect the bank’s growth to be driven by:
    a) **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. The bank bucked the decline in loans trend in the sector, and recorded a 22.1% growth in loans. 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 is expected to grow at a 5-year CAGR of 10.0%

Income Statement	2017	2018	2019e	2020e
Net Interest Income	10.6	12.1	12.9	14.4
Non Funded Income	8.4	10.0	11.4	12.2
Loan Loss Provision	(2.8)	(2.1)	(2.6)	(2.8)
Total Operating Expenses	**(13.7)**	**(13.1)**	**(14.9)**	**(16.4)**
Profit Before Tax	5.4	9.0	9.4	10.2
Profit After tax	4.3	6.3	6.6	7.2
% PAT Change YoY	**-2.5%**	**45.8%**	**4.9%**	**8.8%**
EPS	10.9	15.9	16.7	18.1
DPS	5.3	5.8	5.8	5.8
Cost to Income	57.2%	50.2%	50.5%	51.0%
NIM	**5.1%**	**5.0%**	**4.9%**	**4.9%**
ROaE	10.4%	14.3%	14.1%	14.0%
ROaA	1.9%	2.3%	2.2%	2.1%

Balance Sheet	2017	2018e	2019e	2020e
Net Loans and Advances	143.3	175.0	177.4	198.0
Other Assets	105.5	115.6	140.8	154.1
Total Assets	**248.7**	**290.6**	**318.1**	**352.1**
Customer Deposits	193.4	219.5	242.7	271.9
Borrowings	4.0	7.1	7.1	7.1
Other Liabilities	8.4	19.4	19.4	19.4
Total Liabilities	**205.8**	**245.9**	**269.2**	**298.3**
Shareholders Equity	43.0	44.6	48.9	53.8
Book value Per share	108.7	112.9	123.7	136.1
% Change in BVPS	**7.0%**	**3.9%**	**9.6%**	**10.0%**

Valuation Summary

Stanbic Holdings is undervalued with a potential upside of 20.6%

Cost of Equity Assumptions:	19-Apr-19
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.8
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.0%
Cost of Equity	20.1%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	21.8%
Return on Average Equity 2023f	14.3%
Terminal Price to Book value per share	1.1x
Shareholder Equity - FY23e	75.0
Terminal Value-(Year 2023)	86.6

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	130.7	40%	52.3
Residual income	115.0	35%	40.2
PBV Multiple	81.5	20%	16.3
PE Multiple	94.4	5%	4.7
Target Price			**113.6**
Current Price			**99.0**
Upside/(Downside)			14.7%
Dividend Yield			5.9%
Total return			**20.6%**

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

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B. Tier II Banks

I. I&M Holdings

I&M Holdings Summary of Performance – Q1’2019

- Profit before tax increased by 27.8% to Kshs 3.3 bn, up from Kshs 2.6 bn in Q1’2018. Profit after tax grew by 30.5% to Kshs 2.4 bn in Q1’2019, from Kshs 1.8 bn in Q1’2018
- Total operating income increased by 4.9% to Kshs 5.4 bn, from Kshs 5.2 bn in Q1’2018. This was driven by a 9.7% increase in Non-Funded Income (NFI) to Kshs 2.1 bn, from Kshs 1.9 bn, coupled with a 2.1% increase in Net Interest Income (NII) to Kshs 3.34 bn, from Kshs 3.27 bn in Q1’2018
- Total operating expenses declined by 10.9% to Kshs 2.4 bn, from Kshs 2.7 bn in Q1’2018, largely driven by a 65.5% decline in Loan Loss provisions (LLP) to Kshs 199.4 mn, from Kshs 578.4 mn in Q1’2018. Staff costs however recorded a 13.4% rise to Kshs 1.1 bn, from Kshs 992.3 mn in Q1’2018
- The balance sheet recorded an expansion as total assets increased by 21.6% to Kshs 299.6 bn, from Kshs 246.3 bn in Q1’2018
- The bank’s asset quality improved, with the NPL ratio declining to 13.0% from 13.8% in Q1’2018. NPL coverage also improved to 57.4% up from 39.5% in Q1’2018, as the 32.7% rise in provisions to Kshs 7.1 bn from Kshs 5.3 bn in Q1’2018 outpaced the 6.1% growth in gross NPL to Kshs 23.7 bn in Q1’2019, from Kshs 22.4 bn in Q1’2018
- Going forward, we expect the bank’s growth to be driven by:
    a) **NFI 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
    b) **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.

Financial Statement Extracts

I&M Holdings PAT is expected to grow at a 5-year CAGR of 10.4%

Income Statement	2017	2018	2019f	2020f
Net Interest Income	15.6	15.6	17.1	18.5
Non- Funded Income	5.8	7.6	8.8	9.9
Total Operating Income	**9.8**	**8.0**	**8.3**	**8.5**
Loan Loss Provision	4.1	3.8	3.2	3.9
Other Operating Expenses	4.1	4.4	5.4	6.0
Total Operating Expenses	**12.0**	**12.3**	**13.1**	**14.7**
Profit Before Tax	9.9	11.5	13.1	14.0
Profit After Tax	7.3	8.5	9.2	9.8
% PAT Change YoY	**(6.4%)**	**17.1%**	**7.8%**	**6.9%**
EPS	17.6	20.6	11.1	11.9
DPS	3.5	3.9	3.9	3.9
Cost to Income	56.2%	53.0%	50.5%	51.7%
NIM	7.8%	6.7%	6.3%	6.3%
ROaE	16.6%	17.7%	17.0%	17.2%
ROaA	3.0%	3.1%	2.9%	2.9%
Balance Sheet	**2017**	**2018**	**2019f**	**2020f**
Government securities	51.7	52.2	56.8	63.0
Net Loans and Advances	153.0	166.7	186.0	206.5
Total Assets	**240.1**	**288.5**	**323.6**	**356.8**
Customer Deposits	169.3	213.1	241.6	268.2
Total Liabilities	**193.1**	**237.6**	**266.9**	**293.5**
Shareholders Equity	44.3	47.9	53.7	60.3
Book Value Per Share	107.2	115.8	65.0	72.9
% BVPS Change YoY	**13.6%**	**8.0%**	**-43.9%**	**12.2%**

Valuation Summary

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

Cost of Equity Assumptions:	14/06/2019
Default Spread Adjusted Risk free rate	13.20%
Beta	0.5
Mature Market Risk Premium	7.6%
Extra Risk Premium	0.5%
Cost of Equity	17.5%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	21.34%
Return on Average Equity 2023	16.9%
Justified Price to Book value per share	1.2x
Shareholder Equity - FY23e (mns)	87,839.89
Terminal Value-(Year 2023) (mns)	111,794.26

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	88.64	40%	35.5
Residual income	93.51	35%	32.7
PBV Multiple	51.63	20%	10.3
PE Multiple	60.48	5%	3.0
Target Price			**81.5**
Current Price			**57.0**
Upside/(Downside)			43.0%
Dividend yield			6.1%
Total return			**49.2%**

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

II. National Bank of Kenya

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National Bank's Summary of Performance – Q1'2019

- National Bank recorded a profit before tax of Kshs 0.2 bn, up from a loss before tax of Kshs 0.5 bn in Q1'2018. Profit after tax grew to Kshs 0.1 bn in Q1'2019, from a loss after tax of Kshs 0.1 bn in Q1'2018
- Total operating income increased by 25.8% to Kshs 2.2 bn, from Kshs 1.8 bn in Q1'2018, driven by a 41.7% increase in Net Interest Income (NII) to Kshs 1.7 bn, from Kshs 1.2 bn in Q1'2018, which more than offset the 9.2% decline in Non-Funded Income (NFI) to Kshs 0.5 bn, from Kshs 0.6 bn in Q1'2018
- Total operating expenses rose by 22.2% to Kshs 2.1 bn, from Kshs 1.7 bn in Q1'2018, largely driven by an increase in Loan Loss Provisions (LLP) to Kshs 0.4 bn, from a write back of Kshs 70.8 mn in Q1'2018, coupled with a 5.3% increase in staff costs to Kshs 1.0 bn, from Kshs 0.9 bn in Q1'2018
- The balance sheet contracted as total assets declined by 0.5% to Kshs 104.7 bn, from Kshs 105.2 bn in Q1'2018. The contraction was largely due to the 10.2% decline in the loan book to Kshs 45.9 bn, from Kshs 51.1 bn. Total liabilities declined by 1.3% to Kshs 97.5 bn, from Kshs 98.8 bn in Q1'2018, caused by the 55.8% decline in other liabilities to Kshs 2.9 bn, from Kshs 6.6 bn in Q1'2018.
- The bank experienced a deterioration in asset quality, with Gross Non-Performing Loans (NPLs) increasing by 8.8% to Kshs 31.5 bn in Q1'2019, from Kshs 28.9 bn in Q1'2018. The NPL ratio thus deteriorated to 48.5% in Q1'2019, from 42.9% in Q1'2018
- Going forward, we expect the bank to focus on :
    a) **Asset quality improvement:** With the bank's deteriorated asset quality, the bank's focus on recoveries and remediation of troubled entities should significantly aid the bank in improving the quality of its book. Furthermore, the bank's capital position would need to be improved, and improve the bank's lending, and deposit mobilization capacity, which will be boosted by the proposed merger with KCB Group

Financial Statements Extracts

NBK'S PAT is expected to grow at a 5-year CAGR of 120.0% given the low FY'18 base

Income Statement	2017	2018e	2019f	2020f	2021f
Net Interest Income	6.7	6.0	5.9	6.0	6.0
Non Funded Income	2.4	2.0	2.0	2.1	2.2
Loan Loss Provision	0.8	0.2	0.7	0.7	0.8
Other Expenses	7.6	7.4	6.6	6.7	6.7
Total Operating Expenses	**8.4**	**7.6**	**7.3**	**7.4**	**7.5**
Profit Before Tax	0.8	(0.1)	0.6	0.7	0.7
Profit After tax	**0.4**	**0.0**	**0.4**	**0.5**	**0.5**
% PAT Change YoY	**479.0%**				**1.4%**
EPS	1.2	0.0	1.2	1.5	1.5
DPS	-	-	-	-	-
Cost to Income	83.2%	92.0%	83.9%	81.9%	81.7%
NIM	7.4%	6.5%	6.2%	6.2%	6.1%
ROaE	5.8%	0.1%	5.7%	6.7%	6.3%
ROaA	0.4%	0.0%	0.4%	0.4%	0.4%

Balance Sheet	2017	2018e	2019f	2020f	2021f
Net Loans and Advances	52.4	47.8	46.3	47.2	48.2
Government Securities	35.7	46.3	46.8	47.7	48.7
Other Assets	21.8	20.7	20.0	22.0	24.3
Total Assets	109.9	114.8	113.1	117.0	121.2
Customer Deposits	94.3	98.9	95.5	97.4	99.3
Other Liabilities	8.4	9.0	10.2	11.7	13.5
Total Liabilities	102.6	107.9	105.7	109.1	112.8
Shareholders Equity	7.2	7.0	7.4	7.9	8.4
Book value Per share	21.4	20.6	21.7	23.2	24.7
% Change in BVPS	**4.7%**	**-3.6%**	**5.6%**	**6.9%**	**6.5%**

Valuation Summary

NBK is overvalued with a potential downside of 3.9%

Cost of Equity Assumptions:	19-Apr-19
Default Spread Adjusted Risk free rate*	13.2%
Beta	1.3
Mature Market Risk Premium	7.6%
Extra Risk Premium	2.5%
Cost of Equity	26.7%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	23%
Return on Average Equity	5.9%
Terminal Price to Book value per share	0.31x
Preference Shares	5.68
Shareholder Equity - FY23e	9.51
Terminal Value-(Year 2022)	2.97

Valuation Summary:	Implied Price	Weighting	Weighted Value
Integrated DDM	6.33	40%	2.5
Residual Income	8.87	35%	3.1
PBV Multiple	3.06	20%	0.6
PE Multiple	4.47	5%	0.2
Target Price			**3.9**
Current Price			**4.1**
Upside/(Downside)			**(3.9%)**

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

III. HF Group

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HF Group Summary of Performance – Q1'2019

- HF Group recorded a loss before tax of Kshs 157.7 mn, from a profit before tax of Kshs 52.9 mn in Q1'2018. HF Group also recorded a loss after tax of Kshs 158.3 mn from a profit after tax of Kshs 37.1 mn in Q1'2018
- Total operating income declined by 21.6% to Kshs 769.5 mn, from Kshs 1.0 bn in Q1'2018. This was driven by a 26.7% decline in Net Interest Income (NII) to Kshs 510.8 mn, from Kshs 697.2 mn in Q1'2018 coupled with an 8.8% decline in Non-Funded Income (NFI) to Kshs 258.7 mn from Kshs 283.8 mn in Q1'2018
- Total operating expenses declined marginally by 0.1% to Kshs 927.1 mn from Kshs 928.0 mn in Q1'2018, largely driven by a 17.5% decline in other expenses to Kshs 492.4 mn from Kshs 596.6 mn in Q1'2018
- The balance sheet recorded a contraction as total assets declined by 11.6% to Kshs 59.1 bn, from Kshs 66.8 bn in Q1'2018. The contraction was mainly driven by a 13.9% decline in the loan book to Kshs 42.0 bn from Kshs 48.8 bn in Q1'2018
- The bank experienced a deterioration in asset quality, with gross non-performing loans (NPLs) rising by 67.5%, to Kshs 14.2 bn in Q1'2019, from Kshs 8.5 bn in Q1'2019. This warranted increased provisioning by 28.5% to Kshs 2.5 bn from Kshs 1.9 bn in Q1'2018
- Going forward, we expect the bank's growth to be driven by:
  a) **NFI growth expansion**: The growth in NFI could be driven by increased adoption of alternative channels. The bank is currently focusing on deepening its digital banking proposition having launched their digital banking platform in July, dubbed HF Whizz, which will enable customers to open an account, access loans, and deposit and transfer cash on mobile phones in a bid to grow non – funded income streams

Financial Statements Extracts

HF Group's PAT is expected to grow at a 5-year CAGR of 5.0%

Income Statement	2017	2018	2019f	2020f
Net Interest Income	3.0	2.3	2.4	2.2
Non- Funded Income	1.3	1.3	1.3	1.4
Total Operating Income	**4.3**	**3.6**	**3.7**	**3.7**
Loan Loss Provision	(0.6)	(0.4)	(0.3)	-0.5
Other Operating Expenses	(3.4)	(3.9)	(3.5)	-3.5
Total Operating Expenses	**(4.0)**	**(4.2)**	**(3.8)**	**-4.0**
Profit Before Tax	0.3	(0.7)	(0.1)	-0.3
Profit After Tax	0.1	(0.6)	(0.1)	-0.2
EPS	0.4	(1.7)	(0.2)	(0.7)
DPS	0.35	0.0	0.0	0.0
Cost to Income	92.3%	118.2%	102.8%	109.2%
NIM	5.2%	4.4%	5.0%	4.7%
ROaE	1.1%	(5.5%)	(0.7%)	(2.4%)
ROaA	0.2%	(0.9%)	(0.1%)	(0.4%)
Balance Sheet	**2017**	**2018**	**2019f**	**2020f**
Government securities	2.3	3.2	3.3	3.1
Net Loans and Advances	49.6	43.4	42.0	42.1
Other Assets	15.6	13.9	12.2	11.9
Total Assets	**67.5**	**60.5**	**57.5**	**57.1**
Customer Deposits	36.7	34.7	32.8	32.6
Other Liabilities	19.4	15.5	14.8	14.8
Total Liabilities	**56.1**	**50.2**	**47.6**	**47.4**
Shareholders Equity	11.4	10.4	9.9	9.7

Valuation Summary

HF Group is overvalued with a total potential downside of 42.1%

Cost of Equity Assumptions:	14-Jun-19
Default Spread Adjusted Risk free rate	13.2%
Beta	1.10
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.5%
Cost of Equity	23.3%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	22.4%
Return on Average Equity	6.0%
Terminal Price to Book	0.6x
Shareholder Equity - FY23e	8.9
Terminal Value-(Year 2023)	5.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	7.0	40%	2.8
Residual Income	(3.3)	35%	(1.2)
PTBV Multiple	5.0	20%	1.0
PE Multiple	4.4	5%	0.2
Fair Value			**2.9**
Current Price			**5.0**
Upside/(Downside)			(42.1%)
Dividend Yield			0.0%
Total return			***(42.1%)***

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

Appendix

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Feedback Summary

During the preparation of this Q1'2019 Banking Sector Report, we shared with the subject companies the operating metrics that were used in the rankings for their confirmation and verification

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

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

Thank You!

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