

Valuation Summary

- We are of the view that I&M Holdings is a “Buy” with a target price of Kshs 56.8, representing an upside of 22.1%, from the current price of Kshs 46.5 as of 30th August, inclusive of a dividend yield of 8.4%,
- I&M Holdings is currently trading at P/TBV of 0.7x and a P/E of 8.5x vs an industry average of 1.3x and 6.5x, respectively.

Income Statement

I&M Holdings released their H1'2019 results, registering core earnings per share growth of 17.0% to Kshs 11.0 from Kshs 9.4 in H1'2018, lower than our expectation of a 41.6% decrease to Kshs 5.5. Performance was driven by a 9.1% increase in operating income to Kshs 11.6 bn from Kshs 10.6 bn in H1'2018, which outpaced the marginal increase in operating expenses by 0.9% to Kshs 5.74 bn from Kshs 5.69 bn recorded in H1'2018. However, after adjusting for the bonus issue of 1:1 that was issued during Q1'2019, core earnings per share came in at to Kshs 5.5. Highlights of the performance from H1'2018 to H1'2019 include:

- Total operating income increased by 9.1% to Kshs 11.6 bn from Kshs 10.6 bn in H1'2018. This was due to a 21.9% increase in Non-Funded Income (NFI) to Kshs 4.5 bn from Kshs 3.7 bn in H1'2018, coupled with a 2.2% growth in Net Interest Income (NII) to Kshs 7.0 bn from Kshs 6.9 bn recorded in H1'2018,
- Interest income increased by 8.8% to Kshs 12.7 bn from Kshs 11.7 bn in H1'2018. The interest income on loans and advances increased by 14.3% to Kshs 10.2 bn from Kshs 9.0 bn in H1'2018. However, the interest income on government securities decreased by 18.8% to Kshs 2.1 bn in H1'2019 from Kshs 2.6 bn. The yields on interest earning assets stood at 10.8% in H1'2019, a decline from 11.3% recorded in H1'2018, due to declining yields on government securities and a relatively lower Central Bank Rate (CBR) currently at 9.0%
- Interest expense increased by 18.3% to Kshs 5.7 bn from Kshs 4.8 bn in H1'2018, as interest expense on customer deposits increased by 21.5% to Kshs 5.1 bn from Kshs 4.2 bn in H1'2018. Interest expense on deposits from other banking institutions declined by 3.2% to Kshs 108.9 mn from Kshs 112.5 mn in H1'2018. The cost of funds increased marginally to 4.7% from 4.6% in H1'2018, indicating that expensive interest bearing accounts were opened as deposits grew by 12.5%. The Net Interest Margin declined to 6.1% from 7.1% in H1'2018,
- Non-Funded Income increased by 21.9% to Kshs 4.5 bn from Kshs 3.7 bn in H1'2018. The increase in NFI was driven by a 12.7% increase in fees and commission income on loans to Kshs 0.9 bn from Kshs 0.8 bn in H1'2018, coupled with a 135.2% increase in other income to Kshs 1.1 bn from Kshs 0.5 bn in H1'2018. Other fees and commissions increased by 1.6% to Kshs 1.23 bn from Kshs 1.21 bn in H1'2018, while forex trading income rose by 3.8% to Kshs 1.3 bn from Kshs 1.2 bn in H1'2018. The revenue mix shifted to 60:40 funded to non-funded income from 65:35 in H1'2018, owing to the faster increase in NFI compared to NII,
- Total operating expenses posted a marginal growth of 0.9% to Kshs 5.74 bn from Kshs 5.69 bn, largely driven by a 13.5% increase in staff costs to Kshs 2.3 bn in H1'2019 from Kshs 2.0 bn in H1'2018. Loan loss provisions (LLP) decreased by 21.5% to Kshs 1.1 bn in H1'2019 from Kshs 1.4 bn in H1'2018,
- The cost to income ratio improved by 4.0% points to 49.7% from 53.7% in H1'2018. Without LLP, however, the cost to income ratio improved to 40.1% from 40.4% in H1'2018, implying a lower cost of risk due to the decrease in LLP,

- Profit before tax recorded a 15.2% growth to Kshs 6.2 bn from Kshs 5.4 bn in H1'2018. Profit after tax increased by 17.0% Kshs 4.5 bn in H1'2019 from Kshs 3.9 bn recorded in a similar period in 2018.

Balance Sheet

- The balance sheet recorded an expansion with total assets growth of 12.0% to Kshs 317.1 bn from Kshs 283.1 bn recorded in H1'2018. This growth was largely driven by a 5.7% increase in net loans and advances to Kshs 172.2 bn in H1'2019 from Kshs 162.8 bn in H1'2018, and a 9.2% growth in deposits and balances due from banking institutions abroad to Kshs 43.5 bn from Kshs 39.8 bn in H1'2018. Government securities increased by 28.5% to Kshs 46.4 bn from Kshs 36.1 bn in H1'2018,
- Total liabilities recorded a growth of 11.2% to Kshs 261.6 bn from Kshs 235.3 bn recorded in H1'2018, driven by a 12.5% increase in customer deposits to Kshs 237.2 bn from Kshs 210.9 bn in H1'2018. Deposits per branch increased by 12.5% to Kshs 5.6 bn from Kshs 5.0 bn in H1'2018 as the bank has not increased its branch network from the current 42 branches,
- The loan to deposit ratio increased marginally to 78.0% from 77.2% in H1'2018,
- Gross non-performing loans increased by 9.1% to Kshs 24.4 bn in H1'2019 from Kshs 22.4 bn in H1'2018. However, the NPL ratio remained unchanged at 13.0% in H1'2019. General loan loss provisions increased by 49.1% to Kshs 8.3 bn from Kshs 5.9 bn in H1'2018, hence an improvement in NPL coverage to 62.4% in H1'2019 from 43.4% in H1'2018,
- Shareholders' funds increased by 16.2% to Kshs 52.4 bn from Kshs 45.1 bn recorded in H1'2018,
- I&M Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 16.1%, 5.6% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 18.4%, exceeding the statutory requirement by 3.9. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 16.3%, while total capital to risk weighted assets came in at 18.6%, indicating that the bank's total capital relative to its risk-weighted assets decreased by 0.2% due to the impact of IFRS 9,
- I&M Holdings currently has a return on average assets of 1.5% and a return on average equity of 8.6%.

Key Take-Outs:

- a. The bank maintained its continual rise in NFI recording a 21.9% growth to Kshs 4.5 bn from Kshs 3.7 bn in H1'2018. This resulted in the revenue contribution mix shifting to 60:40 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 13.0% while NPL coverage improved to 62.4% in H1'2019 from 43.4% in H1'2018. Further, the 49.1% rise in provisions to Kshs 8.3 bn from Kshs 5.9 bn in H1'2018, outpaced the 9.1% growth in gross NPL to Kshs 24.4 bn in H1'2019 from Kshs 22.4 bn in H1'2018.

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 its performance;

Balance Sheet (mns)	H1'2018	H1'2019	y/y change	H1'2019e	Expected y/y change	Variance in Actual Growth vs. Expected
Net Loans and Advances	162,823.3	172,163.9	5.7%	176,997.3	8.7%	(3.0%)
Total Assets	283,070.2	317,053.7	12.0%	307,527.6	8.6%	3.4%
Customer Deposits	210,897.8	237,242.3	12.5%	226,919.6	7.6%	4.9%
Total Liabilities	235,255.7	261,619.2	11.2%	252,203.7	7.2%	4.0%
Shareholder's Funds	45,084.9	52,376.8	16.2%	52,281.3	16.0%	0.2%

Balance sheet ratios	H1'2018	H1'2019	% y/y change
Loan to Deposit Ratio	77.2%	78.0%	0.8%
Return on average equity	16.0%	8.8%	(7.2%)
Return on average assets	2.7%	1.5%	(1.3%)

Income Statement(mns)	H1'2018	H1'2019	y/y change	H1'2019e	Expected y/y change	Variance in Actual Growth vs. Expected
Net Interest Income	6,865.8	7,017.7	2.2%	15,439.8	124.9%	(122.7%)
Net non-Interest Income	3,720.1	4,536.3	21.9%	7,877.9	111.8%	(89.8%)
Total Operating income	10,585.8	11,554.0	9.1%	11,751.6	11.0%	(1.9%)
Loan Loss provision	(1,411.9)	(1,108.7)	(21.5%)	(859.3)	(39.1%)	17.7%
Total Operating expenses	(5,687.3)	(5,738.4)	0.9%	(5,581.0)	(1.9%)	2.8%
Profit before tax	5,398.0	6,219.6	15.2%	6,454.2	19.6%	(4.3%)
Profit after tax	3,868.1	4,525.9	17.0%	4,517.9	16.8%	0.2%
Core EPS	4.5	5.7	17.0%	5.5	(41.6%)	2.7%

Income statement ratios	H1'2018	H1'2019	% y/y change
Yield from interest-earning assets	5.3%	5.1%	(0.2%)
Cost of funding	2.3%	2.3%	0.0%
Net Interest Margin	7.1%	6.1%	(1.0%)
Cost to Income	53.7%	49.7%	(4.1%)
Cost to Assets	2.0%	1.8%	(0.2%)
Net Interest Income as % of operating income	65%	61%	(4.1%)
Non-Funded Income as a % of operating income	35%	39%	4.1%

Capital Adequacy Ratios	H1'2018	H1'2019
Core Capital/Total Liabilities	20.3%	19.8%
Minimum Statutory ratio	8.0%	8.0%
Excess	12.3%	11.8%

Core Capital/Total Risk Weighted Assets	16.5%	16.1%
Minimum Statutory ratio	10.5%	10.5%
Excess	6.0%	5.6%
Total Capital/Total Risk Weighted Assets	18.2%	18.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	3.7%	3.9%
Liquidity Ratio	45.5%	48.8%
Minimum Statutory ratio	20.0%	20.0%
Excess	25.5%	28.8%
Adjusted Core Capital/Total Liabilities	20.38%	20.1%
Adjusted Core Capital/Total RWA	16.53%	16.3%
Adjusted Total Capital/Total RWA	18.63%	18.6%