Cytonn Financial Services Research – Daily Note
27th November, 2017

Market Summary

In today's trading session, the Financial Services sector stocks remained relatively unchanged, with the sector's capitalization coming in at Kshs 797.6 bn from Kshs 796.3 bn recorded on Friday. Among the top loser's today included HF Group, losing 2.0% after posting an 80.9% y/y decline in core earnings per share (EPS) in Q3'2017 results, and Sanlam Kenya, which lost 2.7%.

Below is a summary of top gainers and losers for the day.

Top Gainers		Top Losers	
NIC Bank	**6.8%**	Sanlam Kenya Plc	**(2.7%)**
Kenya Re	**6.2%**	HF Group	**(2.0%)**
Liberty Holdings	**1.8%**	KCB Group	**(1.8%)**

Earnings Highlights

HF Group and I&M Bank released Q3'2017 results, with both banks posting declines in core Earnings per Share (EPS) and Profit after tax, respectively.

I&M Bank posted a 23.2% y/y decline in Profit After Tax (PAT) to Kshs. 3.9 bn from Kshs 5.1 bn in Q3'2016, attributed to a 27.4% increase in operating expenses to Kshs 6.6 bn from Kshs 5.1 bn despite a 0.6% growth in operating income to Kshs 12.6 bn from Kshs 12.5 bn in Q3'2016. The growth in operating revenue was driven by a 9.3% increase in the Non-Funded Income to Kshs 3.3 bn from Kshs 3.0 bn, following a growth of 24.8% in fees and commissions and loans, despite a 2.2% drop in Funded Income to Kshs 9.3 bn from Kshs 9.5 bn in Q3'2016. The 27.4% increase in operating expenses was due to a 103.7% growth in loan loss provisions to Kshs 1.9 bn from Kshs 0.9 bn, and an 11.7% rise in staff costs to Kshs 2.2 bn from Kshs 2.0 bn in Q3'2016. Thus, the Cost to Income ratio increased to 52.2% from 41.2% in Q3'2016. Despite the decreased profitability, going forward we expect I&M Bank's growth to be supported by (i) revenue diversification with new business lines such as Burbridge Capital, which the bank will leverage on to spur growth, and (ii) expansion and increased growth in regional subsidiaries across Uganda, Tanzania, Mauritius and Rwanda.

HF Group recorded a decline in core earnings per share of 80.9% y/y, in line with our projections of a 72.0% decline, to Kshs 0.2 from Kshs 0.8 in Q3'2016, attributable to a 25.1% decline in operating revenue coupled with a 0.9% increase in operating expenses. Total operating revenue declined by 25.1% y/y to Kshs 2.8 bn from Kshs 3.8 bn, driven by a 29.7% decline in Net Interest Income (NII) to Kshs 2.2 bn from Kshs 3.1 bn in Q3'2016, and a 4.0% decline in Non-Funded Income (NFI) to Kshs 0.64 bn from Kshs 0.67 bn. The decline in NFI is attributable to a 64.4% drop in fees and commissions on loans to Kshs 0.04 bn from Kshs 0.12 bn in Q3'2016. Total operating expenses increased marginally by 0.9% to Kshs 2.59 bn from Kshs 2.57 bn, attributable to an 11.8% increase in other operating expenses to Kshs 1.0 bn from Kshs 0.9 bn in Q3'2016 despite a 4.4% decline in staff costs to Kshs 0.80 bn from Kshs 0.84 bn in Q3'2016 and a 3.2% decline in LLP to Kshs 0.47 bn from Kshs 0.49 bn in Q3'2016. Thus, the Cost to Income ratio worsened to 91.8% from 68.1% in Q3'2016. Moving forward, HF Group's growth will be driven by the group's property and investments subsidiary, HFDI, through partnerships to develop real estate products. HFDI is set to launch Clay City, a Kshs 5.0 bn development. However, since the interest rate cap environment has reduced access to mortgages, leading to declining interest income and making it harder to attract deposits, these two factors will make it very hard for HF Group to record growth.