Kenya Listed Commercial Banks Analysis

Cytonn FY'2017 Banking Sector Report

'Diversification and efficiency key to growth amidst tighter regulation'

16th April, 2018

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I. Overview of the Firm

What We Stand For

Our Mission

We deliver innovative & differentiated financial solutions that speak to our clients' needs

Our Vision

To be Africa's leading investment manager by consistently exceeding clients' expectations

Our Values

People
Passionate and self-driven people who thrive in a team context

Excellence
Delivering the best at all times

Client Focus
Putting clients' interest first at all times

Entrepreneurship
Using innovation and creativity to deliver differentiated financial solutions

Accountability
We take both corporate and personal responsibility for our actions

Integrity
Doing the right things

Strategy is straightforward – just pick a general direction and implement like hell

— Jack Welch

About Us

Cytonn Investments is an independent investments management firm, with offices in Nairobi - Kenya and D.C. Metro - U.S. We are primarily focused on offering alternative investment solutions to global and local institutional investors, individual high net-worth investors, and diaspora investors interested in the East-African region.

Our investments are in real estate and private equity. Real estate investments are made through our development affiliate, Cytonn Real Estate, where we currently have over Kshs. 82 billion (USD 820 mn) of projects under mandate across ten projects. In private equity, we invest in banking, insurance, education, hospitality and technology. Our financial services investments in Sub Saharan Africa are made through our Cytonn Financial Services Fund (CFSF) through which we are the 5th largest shareholder in NIC Bank in Kenya. Investments in education and hospitality are made through Cytonn Education Services and Cytonn Hospitality, respectively

FACT FILE

82 bn	Over Kshs. 82 billion worth of projects under mandate	**7**	Seven offices across 2 continents	**400**	Over 400 staff members	**10**	10 investment ready projects

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 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 CLIENTS SEGMENTS:

- High Net-worth Individuals through Cytonn Private Wealth
- East Africans in the Diaspora through Cytonn Diaspora
- Global and Local Institutional clients

WE INVEST OUR CLIENT FUNDS IN:

- Real Estate
- Private Equity
- Fixed Income Structured Solutions
- Equities Structured Solutions

We collect funds from our clients

We invest them in high growth opportunities

We deliver the best possible returns

Our Business

Where We Operate

Our Business Lines

Investments
Alternative investment manager focused on private equity and real estate

Real Estate
We develop institutional grade real estate projects for investors

Education
We provide education services ranging from early childhood, to primary and secondary, and tertiary in our colleges

Hospitality
We provide hospitality through serviced apartaments and business hotels

Technology
We deliver world-class financial technology solutions

Our Solutions

To unearth the attractive opportunity that exists in alternative markets in Africa, we offer differentiated investment solutions in three main areas:

HIGH YIELD SOLUTIONS

Our expertise in the alternative markets enables us to offer investors high yielding investments. Our robust credit analysis coupled with our quick dealing capabilities, our extensive research coverage and our innovative structuring helps to ensure consistent and above market returns to investors.

REAL ESTATE INVESTMENT SOLUTIONS

Our comprehensive real estate capabilities enable us to find, evaluate, structure and deliver world-class real estate investment products to our investors in the East African region. Our capabilities include fundraising, market research and acquisition, concept design, project management and agency and facility management.

PRIVATE EQUITY

We seek to unearth value by identifying potential companies and growing them through capital provision, partnering with management to drive strategy and institutionalizing their processes. Our areas of focus are Financial Services, Education, Hospitality and Technology Sectors.

Our Products

We serve three main types of clients namely, high net-worth individuals, institutions and retail, each with diverse needs. Below are the suitability criteria for the various products.

	INSTITUTIONAL CLIENTS	HIGH NET WORTH INDIVIDUALS (HNWI)	RETAIL CLIENTS
Cash Management Solutions	●	●	
Regular Investment Plan • Education Investment Plan • Regular Investment Solution • Land Investment Plan	●	●	●
Real Estate Development • Real Estate Developments	●	●	●

Our People

> If you could get all the people in an organization rowing the same direction, you could dominate any industry, in any market, against any competition, at any time.
>
> **— Patrick Lencioni**

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 11 members from diverse backgrounds, each bringing in unique skill-sets to the firm.

Cytonn INVESTMENTS

Board of Directors, continued …

Governance Committees

We have four main board committees to ensure all of Cytonn's functions are done in a fair and transparent manner:

Investments and Strategy Committee

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

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

Audit, Risk and Compliance Committee

The committee establishes and oversees 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

Governance, Human Resources and Compensation Committee

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

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

Technology and Innovation Committee

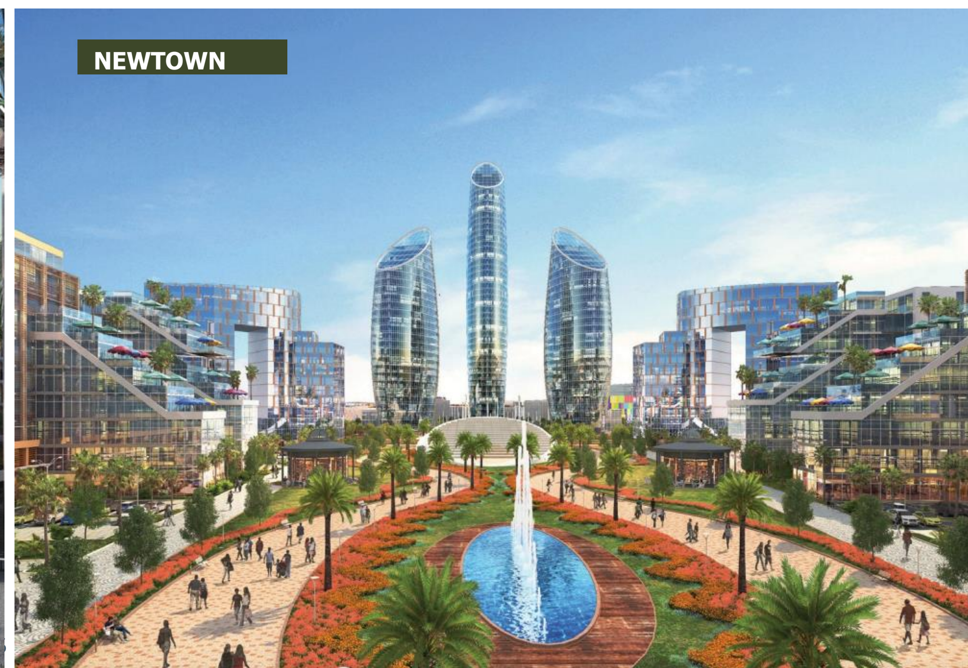
The committee establishes, oversees and implements technical expertise and innovative processes as a driver towards competitiveness. The members are:-

- Nasser Olwero, MPhil (Chair)
- Michael Bristow, MSc
- Patricia N. Wanjama, CPS


AMARA RIDGE


SITU VILLAGE


THE ALMA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II. Kenya Economic Review and Outlook

Kenya Economic Review

Of the 7 indicators we track, 5 are positive and 2 are neutral. we maintain our positive outlook on the 2018 macroeconomic environment

Macro-Economic & Business Environment Outlook					
Macro-Economic Indicators	**2018 Expectations at Beginning of Year**	**YTD 2018 Experience**	**Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
Government Borrowing	Government to come under pressure to borrow as it is well behind both domestic and foreign borrowing targets for FY 2017/18 KRA is unlikely to meet its collection target due to expected suppressed corporate earnings in 2017	The domestic borrowing target was revised downwards to Kshs 297.6 bn from Kshs 410.2 bn, taking the government ahead of their domestic borrowing target, having borrowed Kshs 267.4 bn against a pro-rated target of Kshs 223.2 bn The government has met 72.9% of its total foreign borrowing target following issue of the Kshs 202.0 bn Eurobond and a Kshs 9.5 bn loan from Japan International Corporation Agency (JICA) for the rehabilitation of the Olkaria 1, 2 and 3 Geothermal Power Projects	The Government to be under no pressure to borrow as it is ahead of its domestic target, and has borrowed 72.9% of its full year foreign borrowing target of Kshs 323.2 bn However, with the petition by the Treasury to amend the Division of Revenue Act 2017 and reduce expenditure by counties and an expected improvement in revenue collections, the borrowing targets for the next fiscal year might be lower	**Negative**	**Positive**
Exchange Rate	Currency projected to range between Kshs 102.0 and Kshs 107.0 against the USD in 2018. With the possible widening of the current account deficit being a point of concern, we expect the CBK to continue to support the Shilling in the short term through its sufficient reserves of USD 7.1 bn (equivalent to 4.7 months of import cover)	The Shilling has appreciated by 2.3% against the USD YTD to Kshs 100.8 from Kshs 103.2 at the end of December 2017 Forex reserves hit a high of USD 8.8 bn (equivalent to 5.9 months of import cover) upon receipt of proceeds from the March Eurobond issue. The IMF extended the USD 1.5 bn standby and precautionary facility by 6 months to September 2018	We expect the currency to remain relatively stable against the dollar due to a weaker USD in the global markets, ranging between Kshs 100.0 and Kshs 107.0 to the USD. We expect the CBK to continue supporting the shilling given the level of reserves and the IMF standby facility. However, a worsening current account deficit, which worsened to 7.0% of GDP in Q3'2017, as compared to 6.0% of GDP in a similar period last year, may have a negative effect	**Neutral**	**Neutral**

Kenya Economic Review, continued…

Of the 7 indicators we track, 5 are positive and 2 are neutral. we maintain our positive outlook on the 2018 macroeconomic environment

Macro-Economic & Business Environment Outlook					
Macro-Economic Indicators	**2018 Expectations at Beginning of Year**	**YTD 2018 Experience**	**Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
Interest Rates	Upward pressure expected on interest rates, especially in the first half of the year, as the government falls behind its borrowing targets for the fiscal year. However, with the Banking (Amendment) Act, 2015, the MPC might be unable to do much with the CBR which has remained at 10.0% throughout 2017	The MPC met on 19th March 2018 and reduced the CBR to 9.5% from 10.0%, for the first time since July 2016, noting that there was room for monetary policy easing to further support economic activity. Interest rates have remained stable, with the yields on the T-bills remaining unchanged since the end of the previous quarter	No upward pressure on interest rates, with the government ahead of its pro-rated borrowing targets for the fiscal year. However, with calls to repeal or revise the Banking (Amendment) Act, 2015, the CBK might not be able to maintain low interest rates by rejecting bids deemed expensive in primary bond auctions during the second half of the year, which is also the beginning of a new borrowing cycle by the government	**Neutral**	**Neutral**
Inflation	Inflation expected to average 7.5% compared to 8.0% last year	Inflation in January, February and March 2018 came in at 4.8%, 4.5% and 4.2% with y/y inflation remaining low mainly due to the base effect but m/m inflation rising due to increasing food, fuel, electricity and transport prices	Inflation to average 7.0% in 2018, down from 8.0% in 2017 and within the government target range of 2.5% - 7.5%	**Positive**	**Positive**
GDP	GDP growth projected to come in at between 5.3% - 5.5%	13 research houses, global agencies, and government organizations that we track released their Kenya 2018 GDP projections, with the average coming to 5.5%, inclusive of our projection. The common view was that GDP growth would improve in 2018, from a Treasury estimate of 4.8% in 2017, generally due to (i) recovery in the agriculture sector after the end of the drought, and (ii) recovery in the business environment following easing of political risk arising from the prolonged political impasse over the 2017 presidential elections	We maintain our GDP growth projection for 2018 at between 5.3% - 5.5%, higher than the expected growth rate of 4.8% in 2017, and in line with the 5-year historical average of 5.4%	**Positive**	**Positive**

INVESTMENTS

Kenya Economic Review, continued…

Of the 7 indicators we track, 5 are positive and 2 are neutral. we maintain our positive outlook on the 2018 macroeconomic environment

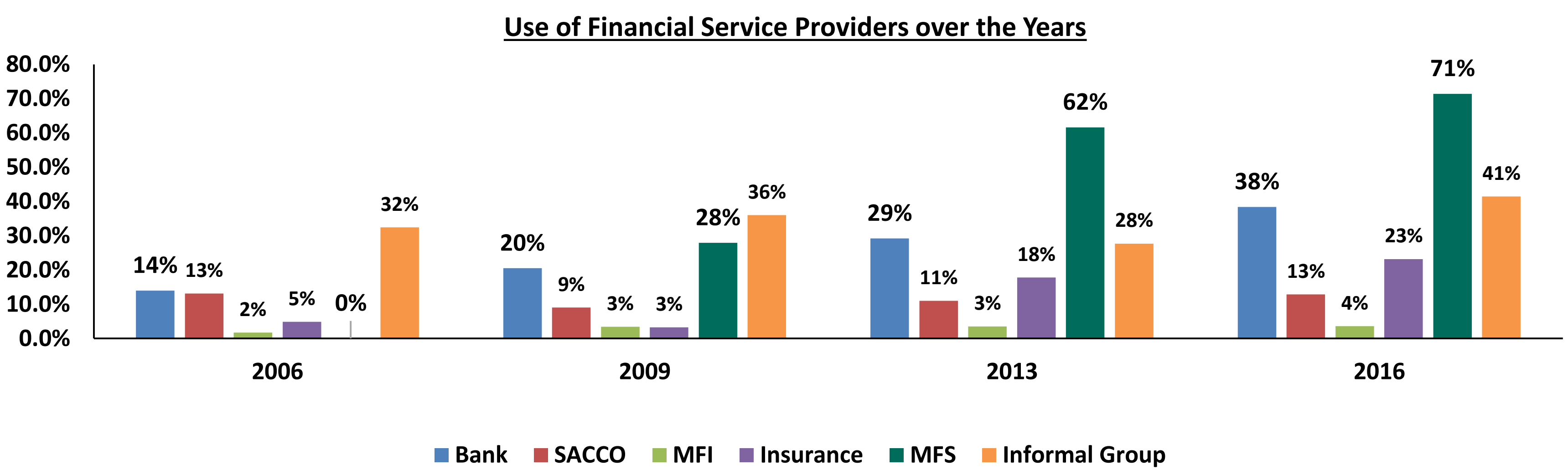
Macro-Economic & Business Environment Outlook					
Macro-Economic Indicators	**2018 Expectations at Beginning of Year**	**YTD 2018 Experience**	**Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
Investor Sentiment	Investor sentiment expected to improve in 2018 given the now settling operating environment after conclusion of the 2017 elections	The Kenya Eurobond was 7.0x oversubscribed partly showing the appetite for Kenyan securities by the foreign community, and investor confidence in Kenya's stable and relatively diversified economy	Given (i) the now settling operating environment following conclusion of the elections, (ii) the expectation that long term investors will enter the market seeking to take advantage of the valuations which are still historically low, and (iii) expectations of a relatively stable shilling, we still expect investor sentiment to improve in 2018	**Positive**	**Positive**
Security	Security expected to be maintained in 2018, especially given that the elections were concluded and the USA lifted its travel warning for Kenya, placing it in the 2nd highest tier of its new 4-level advisory program, indicating positive sentiments on security from the international community	The political climate in the country has eased, compared to Q3'2017, with security maintained and business picking up. Kenya now has direct flights to and from the USA, a possible sign of improving security in the country	We expect security to be maintained in 2018, especially given that the elections are now concluded, the government has settled into office, and the country's two principals are discussing working towards growing the economy	**Positive**	**Positive**

III. Kenya Banking Sector Overview

Kenya Banking Sector Overview

Financial Inclusion in Kenya continues to rise, driven by mobile and digital channels

- In Kenya there are a total of 40 commercial banks, with Imperial Bank under receivership, 1 mortgage finance company, 12 microfinance banks, 8 representative offices of foreign banks, 86 foreign exchange bureaus, 14 money remittance providers and 3 credit reference bureaus
- Financial inclusion in Kenya has continued to rise, with the percentage of the population living within 3 kilometers of a financial services access point rising to 77.0% in 2016 from 59.0% in 2013. This has been driven by digitization, with Mobile Financial Services (MFS) rising to be the preferred method to access financial services in 2016



Source: Central Bank of Kenya

Kenya Banking Sector Overview, continued…

The sector has witnessed several acquisitions over the past 4-years, with one taking place in 2017, the acquisition of Habib Bank Ltd Kenya Branches by Diamond Trust Bank

- Kenya's banking environment is already going through consolidation as evidenced by heightened M&A activity over the last 4 years
- Below is a summary of key transactions done over the last few years and their transaction multiples

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs bns)	Transaction Stake	Transaction Value (Kshs bns)	P/Bv Multiple	Date
Diamond Trust Bank Kenya	Habib Bank Limited Kenya	2.38	100.0%	1.82	**0.8x**	Mar-17
SBM Holdings	Fidelity Commercial Bank	1.75	100.0%	2.75	**1.6x**	Nov-16
M Bank	Oriental Commercial Bank	1.80	51.0%	1.30	**1.4x**	Jun-16
I&M Holdings	Giro Commercial Bank	2.95	100.0%	5.00	**1.7x**	Jun-16
Mwalimu SACCO	Equatorial Commercial Bank	1.15	75.0%	2.60	**2.3x**	Mar-15
Centum	K-Rep Bank	2.08	66.0%	2.50	**1.8x**	Jul-14
GT Bank	Fina Bank Group	3.86	70.0%	8.60	**3.2x**	Nov-13
Average			**80.3%**		**1.8x**	

- For local bank acquisitions, the average price-to-book multiple is at 1.8x, with an average acquisition stake of 80.3%.
- It is notable that acquisitions are also happening at much cheaper valuation compared to earlier bank for example Fina, K-Rep and Equatorial Commercial Bank having been at 3.2x, 1.8x and 2.3x P/B, respectively, while recent acquisitions are happening at between 0.8x to 1.7x P/B, and hence it is a great time to be an acquirer

Growth in the Banking Sector

Listed bank's FY'2017 EPS declined by 0.8% y/y from an average positive growth of 4.4% witnessed in FY'2016, following the capping of interest rates

- Kenya's listed banks recorded a negative EPS growth of 0.8% in FY'2017, compared to an average positive growth of 4.4% in FY'2016. The poor performance was on the back of a decline in Net Interest Income (NII) following the capping of interest rates. The Net Interest Margin (NIM) declined to 8.4% in FY'2017 from 9.2% in FY'2016

- Listed banks recorded net loans and advances growth of 5.6% to Kshs 1.9 tn in FY'2017 from Kshs 1.8 tn in FY'2016, slowing down from the 5 year compounded annual growth rate of 13.2%. On the other hand, deposits grew 11.6% to Kshs 2.4 tn in FY'2017 from Kshs 2.1 tn in FY'2016, also a decline from the 5 year CAGR of 12.5%

Banking Sector Growth Drivers

Alternative channels, cost containment and increased innovation support banks' growth and diversification

1) **Diversification to different revenue streams:** Banks are exploring different avenues of revenue generation such as Bancassurance, in a bid to increase non-funded income and further diversify their revenue sources, given the introduction of the interest rate cap which has negatively impacted funded income for banks
2) **Increased adoption of technology to improve efficiency:** In a bid to minimize costs, banks have embraced technology to reduce operational costs and hence drive efficiency. Some of these measures include integration with mobile application platforms and internet banking to facilitate increased collection of deposits and disbursement of loans with fewer operating costs
3) **Growth of the middle class :** As the middle-class grows rapidly in Kenya, faster than majority of the countries in the region, there is an inherent increase in consumption expenditure and an increase in the percentage of the population that will require banking services
4) **Innovation:** In a bid to reduce operating expenses and improve efficiency, banks are putting an emphasis on innovation, and agency and digital banking are proving to be key drivers of diversification for banks and distribution channels of banking products

Developments in the Banking Sector in 2017

The temporary lifting of the moratorium allowed entry of banks that serve niche market segments, like Dubai Islamic Bank's focus on sharia-compliant banking

1. **Licencing of new commercial banks, following a temporary lifting of the moratorium:** the Central Bank temporarily lifted the moratorium to license new banks, which saw the licensing of Dubai Islamic Bank Limited (DIB) and Mayfair Bank Ltd. DIB became the third fully sharia compliant lender to operate in East Africa after Gulf African Bank Limited and First Community Bank. DIB's entry, which is anchored on its strategic focus of enhancing its international presence, will expand the offerings in the market, particularly in the promising sharia-compliant banking niche

2. **Decline in private sector credit growth:** Private sector credit growth was on a decline coming in at an average of 2.4% in 2017, compared to a 5-year average of 14.0%. The decline was attributed to structural reforms in the banking sector and strict adherence to prudential guidelines in terms of loan book quality and sufficient provisioning. This prompted banks to prefer to lend to the government as opposed to the private sector, which is considered riskier. The situation was also made worse by the interest rate cap, introduced in September 2016

Developments in the Banking Sector in 2017, continued…

CBK received a non-binding offer for Chase Bank while private sector credit growth has been on the decline despite measures taken to improve growth and spark economic growth

3. **Regulations aimed at improving private sector credit growth:** The president signed the Movable Property Security Rights Bill into law, which seeks to facilitate the use of movable assets as collateral for credit facilities. Kenya Institute of Management (KIM) and Kenya Bankers Association (KBA) signed a Memorandum of Understanding (MOU) to train Micro, Small and Medium Enterprises (MSMEs) in a bid to promote financial literacy and credit to MSMEs by educating these businesses on de-risking, to make it easier for banks to lend to them at the prevailing low rates brought about by the capping of interest rates; all in a bid to improve private sector credit growth

4. **Chase Bank sale of its majority stake:** The Central Bank of Kenya (CBK) shortlisted potential investors in Chase Bank, and received a non-binding offer for Chase Bank from SBM Holdings and the CBK approved the transaction early 2018. The interest in Chase Bank by both local and foreign financial services sector players is an indication that the Kenyan banking sector remains attractive as it offers access to high returns, with listed banks having recorded an average return on equity of 13.7% in FY'2017, despite the introduction of the interest rate caps

Developments in the Banking Sector in 2017, continued…

Banks have adopted technology to improve efficiency and promote financial inclusion, while efforts to increase transparency in the true cost of credit, like the Cost of Credit website, were introduced

5. Launch of PesaLink by Kenya Bankers Association (KBA): KBA launched its real-time interbank switch, PesaLink, which has allowed customers make payments between banks in real-time, without the need for intermediaries and customers are also able to initiate transactions from diverse channels including from mobiles, banks' branches, ATMs, agency banking outlets and through the internet

6. Launch of the Cost of Credit website by the KBA and the CBK: This is a website in which commercial banks and micro-finance institutions are required to publish their true cost of credit. This brought about increased transparency, in a bid to spur competitiveness in the banking sector and bring a halt to excessive fees and costs

7. Increased consolidation through M&A activities: The Kenya banking sector has witnessed increased consolidation through acquisition activities, with local banks such as Diamond Trust Bank acquiring Habib Bank, and I&M Holdings' acquisition of Giro Bank; while foreign banks namely M Bank's acquisition of Oriental Commercial Bank, and SBM Holdings, which completed the acquisition of Fidelity Commercial Bank and Chase Bank

Developments in the Banking Sector in 2017, continued…

The banking sector witnessed a deterioration in asset quality over the past year, with the gross non-performing loans in the listed segment rising by 22.8% to Kshs 197.5 bn from Kshs 160.9 bn in FY'2016

8. Staff lay-offs and closure of branches: With rising operating expenses in the sector, and the expected reduced margins owing to the enactment of the Banking (Amendment) Act, 2015, 11 banks announced plans to downsize, close to 1,620 bank employees were laid off, and 39 branches closed, but the total number of branches in the sector rose to 1,182 in FY'2017 from 1,089 in FY'2016

9. Asset Quality – The banking sector witnessed a deterioration in asset quality over the past year, with the gross non-performing loans in the listed segment rising by 22.8% to Kshs 197.5 bn from Kshs 160.9 bn in FY'2016, as the gross NPL ratio rose to 12.3% from 11.8% in FY'2016. We saw banks become more selective, prudent and conservative in terms of loan disbursement, since with the pricing framework, it was difficult to price riskier clients within the loan limit cap in the cost of loans. This saw banks prefer not to lend to consumers but rather invest in risk-free treasuries, which offered better returns on a risk adjusted basis

Effects of Developments in the Banking Sector

Following the capping of interest rates, banks have taken to cost rationalization measures through staff lay offs and closing down redundant branches

Kenya Banking Sector Restructuring			
No.	**Bank**	**Staff Retrenchment**	**Branches Closed**
1.	Bank of Africa	-	12
2.	Barclays Bank	301	7
3.	Ecobank	-	9
4.	Equity Group	400	7
5.	Family Bank	Unspecified	-
6.	First Community Bank	106	-
7.	KCB Group	223	Unspecified
8.	National Bank	150	-
9.	NIC	32	Unspecified
10.	Sidian Bank	108	-
11.	I&M Holdings	-	Unspecified
12.	Standard Chartered	300	4
	Total	**1,620**	**39**

Recent Developments in the Banking Sector

There have been calls by the IMF and the Kenya Parliamentary Budget Office to review or repeal the law capping interest rates, with data confirming that the cap resulted in negative effects on credit growth

1. Calls to repeal the Interest Rate Cap: The CBK and the Treasury confirmed that a preliminary study on the effects of the interest rate cap resulted in negative effects on the growth of credit. The IMF has once again urged Members of Parliament (MPs) to repeal the law capping interest rates, recommending total abolition of the rate cap, stating that it has had a negative impact on the economy, crowding out the private sector and curtailing growth of SMEs. The Kenya Parliamentary Budget Office (KPBO) has put in place a proposition to review the law capping interest rates. The Treasury is planning to introduce a Consumer Protection Law to replace the Banking (Amendment) Act 2016, which stipulated deposit and loan-pricing framework that capped interest rates

2. Loans to banks by international organizations for private sector and SME lending – The International Finance Corporation (IFC), World Bank's private sector lending arm, has advanced a Kshs 15.2 bn loan to Co-operative Bank. The loan is meant for onward lending to small firms, and its tenure is seven-years. The Arab Bank for Economic Development in Africa (BADEA) has also opened a line of credit with HF Group for Kshs 1.5 bn, which is also meant for lending to the SME sector. This highlights the trend that many Kenyan banks are looking for cheaper long-term financing that global banks are willing and able to provide

Recent Developments in the Banking Sector, continued…

The MPC lowered the CBR to 9.5% from 10.0% previously, in order to spur economic activity in the country, and in the process reduced lending rates to a cap of 13.5%

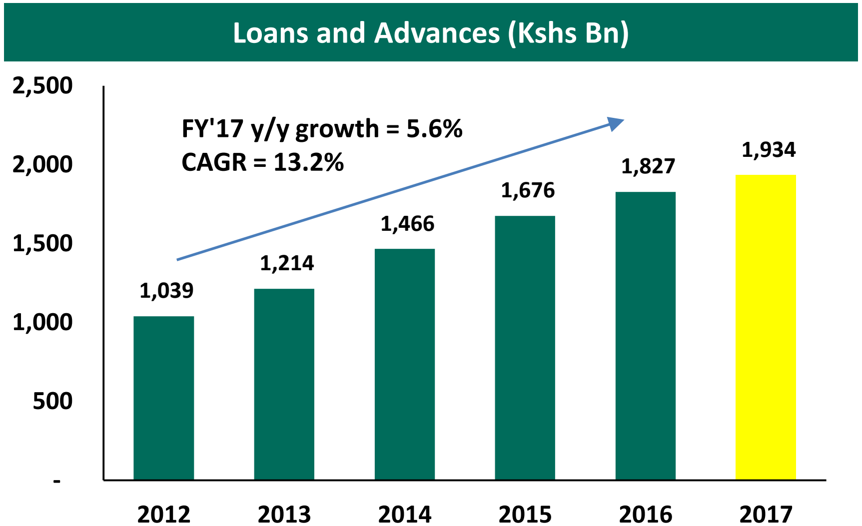
3. Barclays Africa Group to rebrand to ABSA Group: Barclays Africa Group announced that it was changing its Brand and corporate name to Absa Group (Barclays Africa Group), following Barclays Plc selling down its stake to ABSA Group Limited. This will affect Barclays Bank of Kenya which will also rebrand to ABSA in May

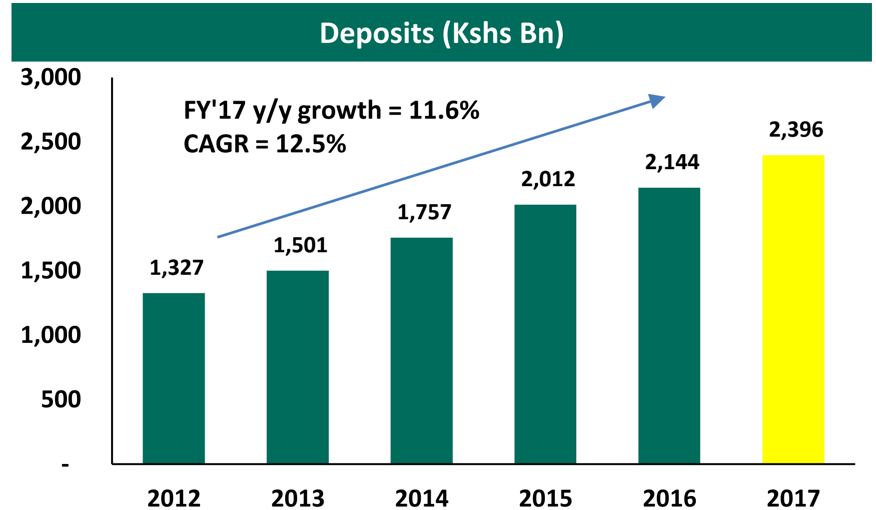
4. Venturing into bancassurance as a source of non-funded income: We have seen further investment by banks in alternative sources of income, with I&M Holdings having completed a full buyout of Youjays Insurance Brokers for an undisclosed amount and Standard Chartered partnering with Sanlam, both in a drive to grow their bancassurance business

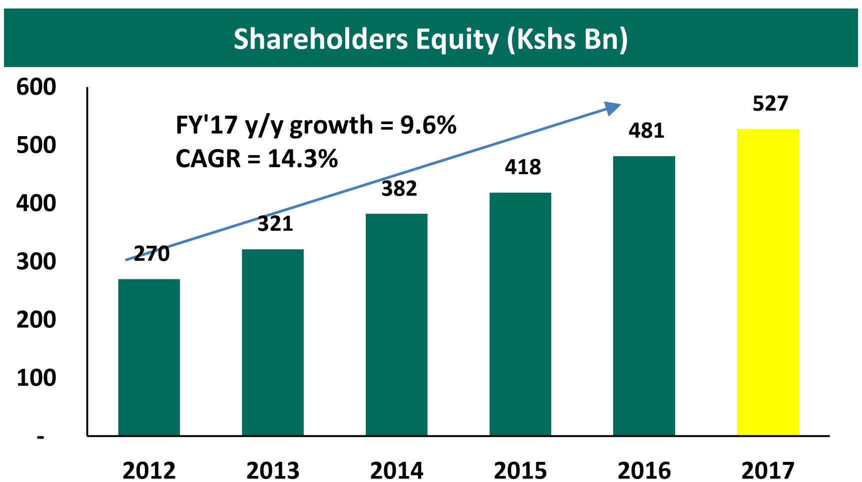
5. Central Bank Rate (CBR) lowered to 9.5% from 10.0%, previously: The MPC met on 19th March, 2018 and reduced the CBR to 9.5% from 10.0%, for the first time since July 2016, noting that there was room for monetary policy easing to further support economic activity. This effectively reduced lending rates to 13.5% (CBR+4.0%) and deposit rates to 6.7% (70.0% of CBR), making credit access by the private sector even harder due to the interest rate cap, given the further decline in private sector credit growth to 2.1% in February 2018 from 2.4% in December 2017

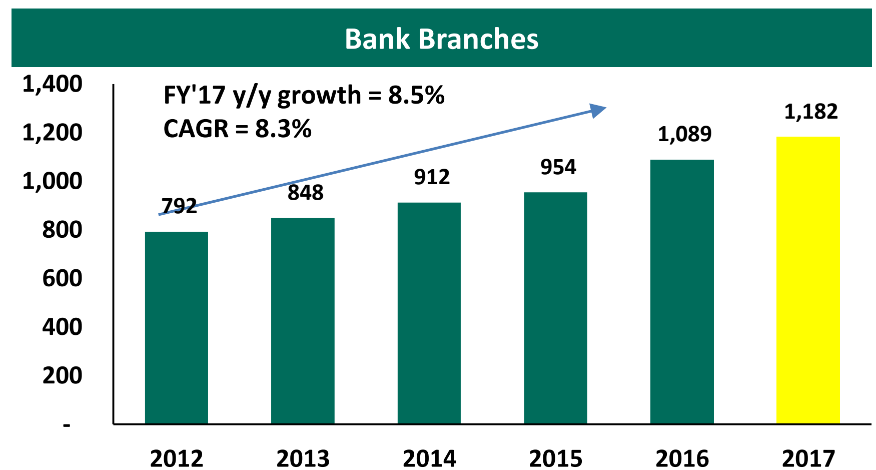
Listed Banking Sector Metrics

Deposit growth remains strong, coming in close to the historical average. Loan growth and branch opening slows down as private sector credit growth slumps and banks embrace alternative distribution channels









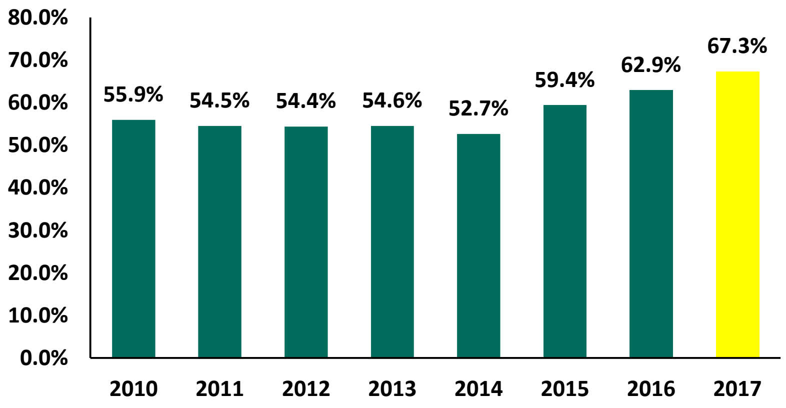
Source: Central Bank of Kenya

Cytonn INVESTMENTS

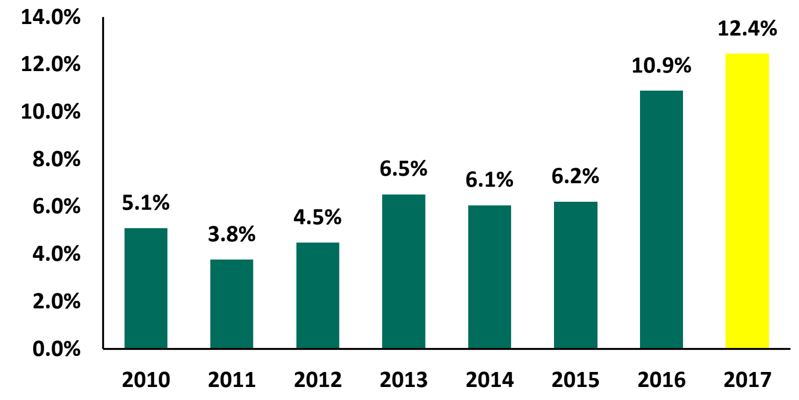
Listed Banking Sector Metrics, continued…

Under the regulated loan pricing framework, we have seen a decline in net interest margins and higher levels of NPLs; and this, coupled with the rising costs are points of concern to the sector

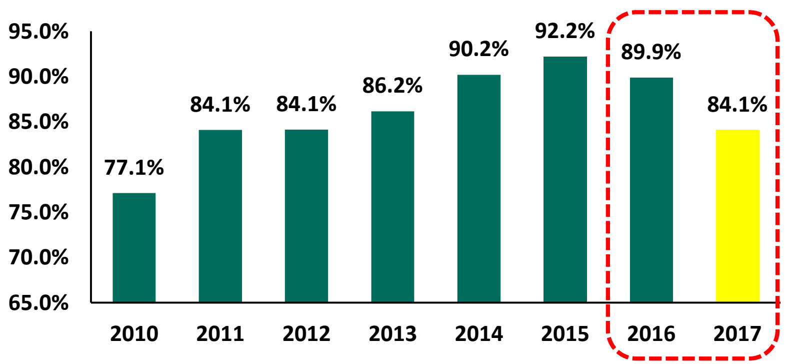
Cost to Income - with LLP (%)



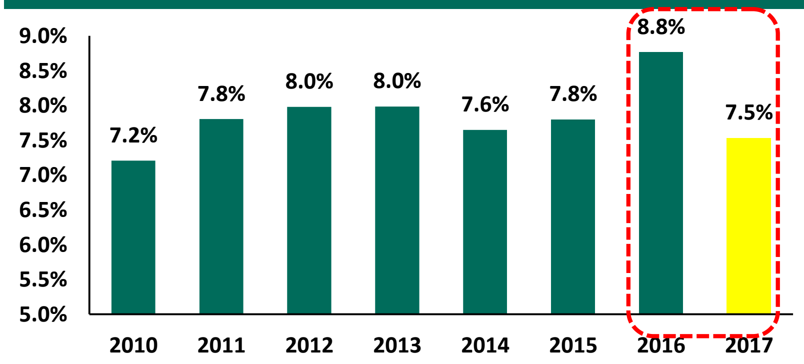
NPLs to Total Loans (%)



Loan to Deposits (%)



Net Interest Margin (%)



- The LDR has declined to 84.1% from 89.9% in 2016, with banks adopting a more prudent credit risk assessment framework to ensure quality loan books

- Bank's NIMs have declined to 7.5% from 8.8% in 2016, following the capping of interest rates, and this has affected the profitability of these banks as the current regulatory framework has compressed margins

Source: Central Bank of Kenya

Listed Banks FY'2017 Earnings & Growth Metrics

Kenya's banking sector FY'2017 core EPS declined by 1.0% compared to a growth of 4.4% in FY'2016

Listed Banks FY'2017 Earnings and Growth Metrics

Bank	Core EPS Growth	Interest Income Growth	Interest Expense Growth	Net Interest Income Growth	Net Interest Margin	Non-Funded Income (NFI) Growth	NFI to Total Operating Income	Growth in Total Fees& Commissions	Deposit Growth	Loan Growth	Growth in Govt. Securities
NBK	479.0%	(17.7%)	(24.9%)	(13.7%)	7.4%	(15.0%)	26.5%	(1.2%)	0.4%	0.4%	(4.8%)
Equity Group	14.0%	(6.6%)	8.1%	(10.2%)	9.0%	24.2%	42.0%	22.0%	10.7%	4.9%	27.3%
KCB Group	(0.1%)	1.4%	(3.1%)	2.9%	8.7%	2.5%	32.2%	16.4%	11.5%	9.6%	7.4%
Stanbic	(2.5%)	(3.0%)	(5.3%)	(2.0%)	5.2%	10.0%	44.2%	38.6%	24.1%	8.1%	42.6%
NIC Group	(4.3%)	(3.2%)	11.5%	(11.5%)	6.3%	3.6%	27.9%	14.2%	24.2%	4.6%	77.9%
Barclays Bank	(6.4%)	(3.4%)	(7.2%)	(2.4%)	9.7%	(9.5%)	27.9%	8.6%	12.5%	(0.7%)	20.1%
I&M Holdings	(7.1%)	(0.1%)	0.0%	0.6%	7.8%	15.9%	27.0%	22.0%	15.5%	13.6%	10.9%
Co-op Bank	(10.0%)	(4.5%)	(3.9%)	(4.7%)	9.2%	5.6%	32.4%	0.3%	9.2%	7.1%	19.7%
DTBK	(10.3%)	2.4%	3.6%	1.5%	6.5%	4.1%	21.1%	5.3%	11.8%	5.2%	23.3%
Standard Chartered	(24.0%)	1.9%	20.3%	(4.1%)	8.4%	2.3%	32.1%	(0.4%)	14.3%	2.9%	26.7%
HF Group	(86.1%)	(17.1%)	(11.1%)	(24.3%)	5.2%	78.2%	31.1%	(37.6%)	(3.7%)	(8.9%)	(44.0%)
Weighted Average*	**(1.0%)**	**(2.4%)**	**2.6%**	**(3.8%)**	**8.4%**	**9.1%**	**33.6%**	**13.4%**	**12.5%**	**6.1%**	**22.2%**
Weighted 2016 Average	**4.4%**	**15.5%**	**6.2%**	**20.3%**	**9.2%**	**2.4%**	**31.0%**	**12.6%**	**6.4%**	**6.3%**	**45.8%**

** The weighted average is based on Market Cap as at 13th April, 2018*

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Listed Banks FY'2017 Operating Metrics

Kenya's banking sector FY'2017 ROACE is at 17.6%

Listed Banks FY'2017 Operating Metrics

Bank	LDR	CIR	ROACE	Deposits per Branch (bns)	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio
Co-operative Bank	88.3%	60.9%	15.9%	1.9	7.2%	37.6%	17.6%
KCB Group	84.6%	59.2%	19.5%	1.9	8.4%	67.9%	15.9%
Diamond Trust Bank	73.6%	59.6%	13.9%	1.9	7.2%	67.5%	13.0%
Equity Group	74.8%	58.7%	21.6%	1.3	6.2%	50.3%	16.6%
I&M Holdings	90.4%	56.2%	17.9%	4.0	12.1%	40.0%	18.5%
NIC Group	86.2%	62.5%	12.9%	3.0	11.9%	45.7%	16.0%
Barclays Bank	90.5%	65.8%	16.0%	2.1	7.1%	70.0%	15.9%
Standard Chartered	59.2%	63.2%	16.5%	4.8	12.8%	74.4%	15.3%
Stanbic Holdings	74.1%	71.7%	10.4%	5.5	7.0%	47.4%	13.5%
HF Group	135.4%	92.3%	1.1%	1.5	15.6%	36.4%	15.6%
National Bank	55.5%	91.4%	5.8%	1.3	40.6%	57.1%	5.6%
Weighted Average*	**80.0%**	**61.1%**	**17.6%**	**2.4**	**8.3%**	**56.4%**	**16.1%**
Weighted 2016 Average	**84.2%**	**51.1%**	**16.8%**	**2.2**	**7.3%**	**57.4%**	**15.9%**

** The weighted average is based on Market Cap as at 13th April, 2018*

Listed Banking Sector Multiples

Kenya's banking sector is currently trading at an average PTBV of 1.8x and a PE of 9.9x

Bank	Share Price*	No. of Shares Issued (bns)	Market Cap (bns)	PTBV	P/E	Dividend Yield
HF Group	12.1	0.4	4.3	**0.3x**	**30.3x**	1.2%
NBK	8.3	0.3	2.8	**0.5x**	**6.8x**	0.0%
NIC Group	44.0	0.6	28.2	**0.9x**	**6.8x**	3.2%
Stanbic	91.0	0.4	36.0	**1.1x**	**8.3x**	5.1%
DTBK	210.0	0.3	55.9	**1.2x**	**9.1x**	1.4%
I&M Holdings	129.0	0.4	53.3	**1.4x**	**7.3x**	2.4%
KCB Group	52.5	3.1	163.0	**1.6x**	**8.2x**	7.1%
Barclays Bank	13.0	5.4	70.6	**1.6x**	**10.2x**	9.7%
Co-op Bank	19.3	5.9	112.9	**1.7x**	**10.8x**	5.9%
Standard Chartered	240.0	0.3	82.4	**1.9x**	**11.9x**	4.0%
Equity Group	55.5	3.8	209.4	**2.5x**	**11.1x**	4.5%
Weighted Average**			**818.9**	**1.8x**	**9.9x**	**5.2%**
Weighted 2016 Average				**1.2x**	**6.7x**	**6.5%**

** Price as at 13th April, 2018*

*** The weighted average is based on Market Cap as at 13th April, 2018*

All values in Kshs unless stated otherwise

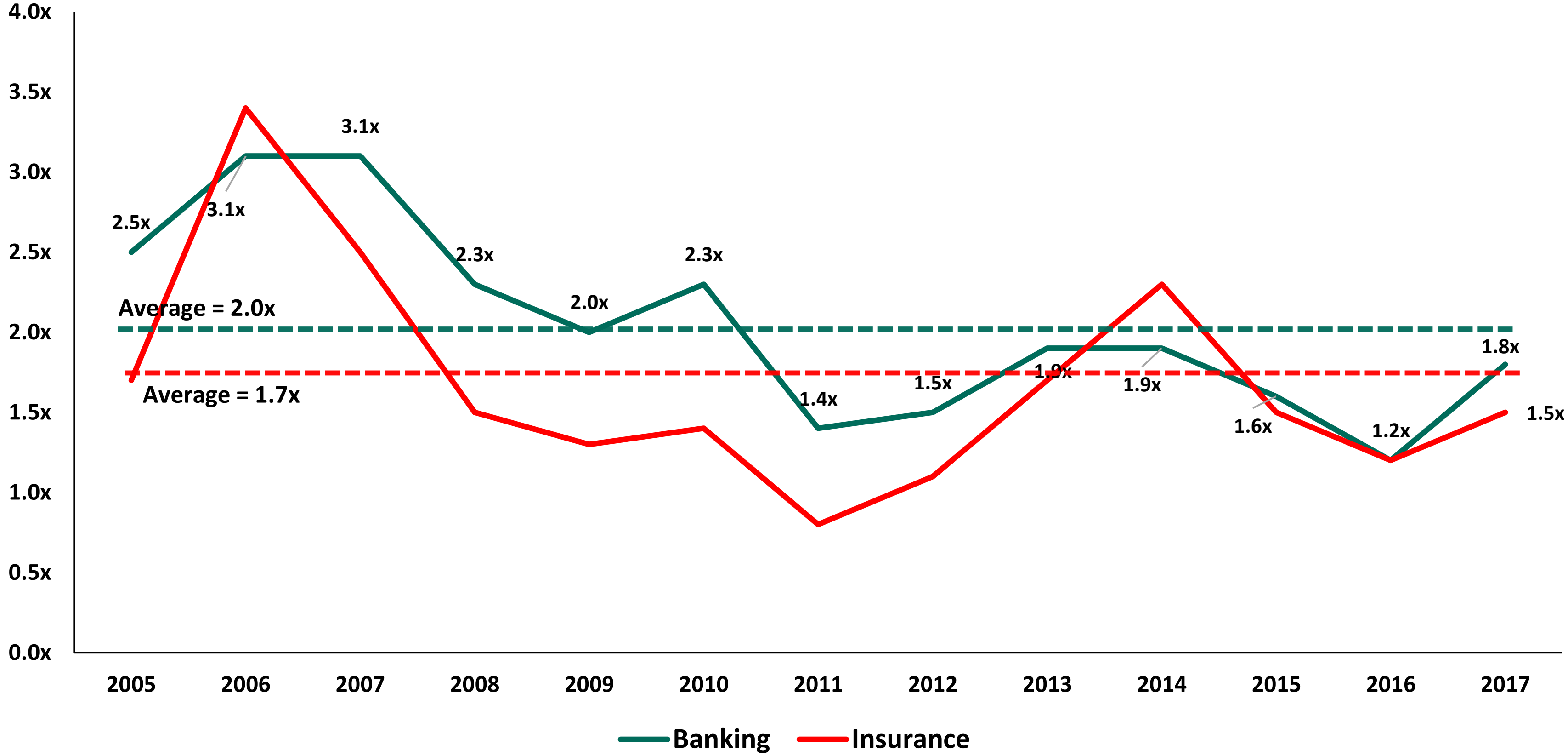
Source: NSE, Cytonn Banking Sector Report

Cytonn INVESTMENTS

Banking Sector Multiples

Listed Banks are currently priced at a PBV of 1.8x, higher than the listed insurance sector at 1.5x

13 year Price to Book Value: Banking and Insurance



On a price to book valuation, listed banks are currently priced at a PBV of 1.8x, higher than listed insurance companies at 1.5x, with both lower than their historical averages of 2.0x for the banking sector and 1.7x for the insurance sector

Source – Cytonn Research

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Summary of the FY’2017 Earnings

Banks have been adversely affected following the capping of interest rates, with the sector recording a 1.0% decline in core EPS, compared to a growth of 4.4% in FY’2016

1. Following a market cap weighted decline of 1.0% in core earnings in FY’2017 compared to a market cap weighted growth of 4.4% in FY’2016 it is clear that the bank earnings were significantly affected by the interest rate cap in 2016
2. Deposits grew at a faster rate than loans at 11.6% compared to loans at 5.6%, but grew slower than the 5-year average of 12.5%
3. The level of NPLs remains a concern within the banking sector with the gross non-performing loan (NPL) ratio for the listed banks rising to 12.4%, from 10.9% in FY’2016. We expect the level of provisioning to increase going forward as banks adopt IFRS 9 that requires a forward looking approach to estimate credit losses

Cytonn INVESTMENTS

IV. Cytonn's Banking Sector Report

Executive Summary

Cytonn has undertaken this report to offer our investors a comprehensive view of the listed banks

- All listed banks in the Kenyan market were analysed by the Cytonn Investment Team
- The analysis was brought about by a need to be able to take a view on the banking sector to determine which banks are the most stable from a franchise value and from a future growth opportunity perspective
- The analysis covers the health and future expected performance of the financial institution, by highlighting their performance using metrics to measure profitability, efficiency, growth, asset quality, liquidity, revenue diversification, capitalization and intrinsic valuation
- The analysis was undertaken using FY'2017 results (franchise value) and analyst's projections of future performance of the banks (future growth opportunities)
- For banks which are part of a group structure, the financials of the group were utilised to take into consideration the listed counter which an investor will purchase
- The overall ranking was based on a weighted average ranking of Franchise value (accounting for 40%) and Intrinsic value (accounting for 60%)
- The top rankings were dominated by local Tier 1 banks which performed well in terms of both Franchise and Intrinsic valuation

Diversification and Efficiency key to growth amidst tighter regulation

Focus Area	Summary	Effect on Banking Sector
Regulation	• **Price controls:** Put in place in the industry following the enactment of the Banking Act (Amendment) 2015 • **Transition to IFRS 9 from IAS 39:** IFRS 9 requires banks to adopt a forward looking approach in credit risk assessment	• Banks have experienced a decline in EPS over 2017, coming in at a 1.0% decline compared to a 5-year average growth of 6.7%; due to compression in net margins, and this has adversely affected the profitability of banks. Exposure in government securities increased with subdued loan growth.
Diversification	• **Increased diversification to non-funded income revenue streams:** With banks registering compressed net interest margins, much of the attention has shifted to non-funded income, as this section of the bank's revenue is not affected by the interest rate caps.	• Non-Funded Income growth has been emphasized in the new bank's business model, rising by 9.1% in 2017, higher than the 5-year average growth of 8.1%, and has shored up banks income during the year with net interest income declining by 3.8% owing to the cap on interest rates
Efficiency	• **Enhancing operational efficiency:** Following the Banking (Amendment) Act 2015, banks have taken proactive measures aimed at increasing operational efficiency and preserving their profit margins	• The sector has witnessed measures such as laying off staff, closure of branches, reviewing operating hours for some branches, or outright sales in the case of struggling Tier III banks • Going forward, we are likely to witness banks' push for efficiency gather pace
Asset Quality	• **Increase in non-performing loans:** With the Gross NPL ratio currently at 12.4% from 8.4% in FY'2016, 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 prudent banking based on a more stringent risk assessment framework • This has led to more prudent provisioning by banks, resulting to lower profitability, and we expect this to continue going forward

Diversification and efficiency will prove to be key in the Banking sector, in the wake of a tighter regulated environment, following the capping of interest rates, adoption of IFRS 9 and deteriorating asset quality, which has seen banks record decrease profitability in 2017

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Rankings by Franchise Value

KCB Group emerged top in the franchise value rankings, with HF Group coming last

Key Ranking Metrics																	
Rank	Bank	LDR *	CIR **	ROACE ***	NIM ****	PEG ratio	P/TBV	Deposit per Branch	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non Interest Income to Revenue	Camel Rating	Corporate Governance Score	Total Score	FY'17 Rank	Q3'17 Rank
1	KCB	1	3	2	4	1	7	7	6	3	5	4	9	1	**53**	**1**	**1**
2	Equity	6	2	1	3	2	11	10	1	6	3	2	1	7	**55**	**2**	**3**
3	Co-op	3	5	6	2	6	9	8	4	10	2	3	4	4	**66**	**3**	**2**
4	I&M	4	1	3	6	3	6	3	8	9	1	9	8	7	**68**	**4**	**5**
5	Barclays	5	8	5	1	10	8	5	3	2	5	7	7	5	**71**	**5**	**4**
6	NIC	2	6	8	9	4	3	4	7	8	4	8	2	9	**74**	**6**	**6**
7	SCBK	9	7	4	5	9	10	2	9	1	8	5	5	3	**77**	**7**	**9**
8	DTBK	8	4	7	8	5	5	6	5	4	10	11	3	2	**78**	**8**	**6**
9	Stanbic	7	9	9	11	8	4	1	2	7	9	1	6	11	**85**	**9**	**8**
10	NBK	10	10	10	7	7	2	11	11	5	11	10	11	6	**111**	**10**	**10**
11	HF Group	11	11	11	10	11	1	9	10	11	7	6	10	9	**117**	**11**	**11**

- The bank ranking assigns a value of 1 for the best performing bank, and a value of 11 for the worst
- The metrics highlighted a bank's profitability, efficiency, growth, asset quality, liquidity, revenue diversification, capitalization and soundness
- KCB Group ranked 1st position on the back of a high return on average equity of 19.5% compared to an industry average of 13.8% as well as an optimal loan to deposit ratio of 84.6%, compared to an industry average of 83.0%
- HF Group ranked 11th, owing to increased costs and low return, with their Cost to Income Ratio and Return on average common equity at 92.3% and 1.1%, respectively, as compared to an industry average of 67.4%, and 13.8%, respectively

- **LDR- Loan to Deposit Ratio*
- ***CIR- Cost to Income Ratio*
- ****ROACE - Return on Average Common Equity*
- *****NIM - Net Interest Margin*

Source: Cytonn Research

Rankings by Intrinsic Value

NIC Group has the highest upside with a total potential return of 42.3%

Banks	Current Price*	Target Price	Upside (Downside)	Dividend Yield	Total Potential Return	FY'2017 Ranking	Q3'2017 Ranking
NIC Group	44.0	61.6	40.0%	2.3%	**42.3%**	**1**	**1**
Diamond Trust Bank	210.0	272.9	29.9%	1.2%	**31.2%**	**2**	**3**
KCB Group	52.5	63.7	21.3%	5.7%	**27.0%**	**3**	**2**
I&M Holdings	129.0	151.2	17.2%	2.7%	**19.9%**	**4**	**5**
Barclays Bank	13.0	13.7	5.2%	7.7%	**12.9%**	**5**	**4**
Co-op Bank	19.3	20.5	6.6%	4.2%	**10.8%**	**6**	**6**
NBK	8.3	8.6	4.2%	0.0%	**4.2%**	**7**	**11**
Equity Group	55.5	54.3	(2.1%)	3.6%	**1.5%**	**8**	**7**
Stanbic Holdings	91.0	87.1	(4.2%)	5.8%	**1.5%**	**9**	**9**
HF Group	12.1	11.0	(9.3%)	2.9%	**(6.4%)**	**10**	**8**
Standard Chartered	240.0	192.6	(19.8%)	7.1%	**(12.7%)**	**11**	**10**

Prices as at 13th April 2018

- The Intrinsic Valuation is computed through a combination of valuation techniques, with a weighting of 75.0% on Discounted Cash flow Methods and 25.0% on Relative Valuation
- NIC Group has the highest upside at 42.3%, followed by DTBK and KCB Group at 31.2% and 27.0%, respectively
- NBK rose 4 places to position 7 from 11 in Q3'2017, with an expected return of 4.2%

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Composite Bank Ranking

Overall, KCB Group ranked highest, while 8 banks shifted positions from Q3'2017

CYTONN'S FY'2017 BANKING REPORT RANKINGS					
Bank	**Franchise Value Total Score**	**Intrinsic Value Score**	**Weighted Score**	**FY'2017 Rank**	**Q3'2017 Rank**
KCB Group	53.0	3.0	23.0	**1**	**1**
Equity Group	55.0	8.0	26.8	**2**	**4**
I&M Holdings	68.0	4.0	29.6	**3**	**7**
Co-operative Bank	66.0	6.0	30.0	**4**	**2**
NIC Bank	74.0	1.0	30.2	**5**	**5**
Barclays Bank	71.0	5.0	31.4	**6**	**3**
Diamond Trust Bank	78.0	2.0	32.4	**7**	**6**
Standard Chartered Bank	77.0	11.0	37.4	**8**	**9**
Stanbic Holdings	85.0	9.0	39.4	**9**	**8**
National Bank of Kenya	111.0	11.0	48.6	**10**	**10**
HF Group	117.0	10.0	52.8	**11**	**11**

- In our ranking, franchise value was assigned a weighting of 40.0% while the intrinsic value was assigned 60.0% weight
- KCB Group maintained the 1st position, while Equity Group moved up 2 positions to 2nd, while I&M Holdings moved up 4 positions to 3rd
- Co-operative Bank declined 2 spots to position 4 from 2nd in Q3'2017, while Barclays Bank declined 3 spots to Position 6 from Position 3 in our Q3'2017 Banking Sector Report
- National Bank and HF Group maintained their positions at 10th and 11th in FY'2017, same as in Q3'2017

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Appendix

A. Metrics Used

Banking Sector Report – Metrics Used

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

1. **Net Interest Margin -** A bank's net interest margin (NIM), is the difference between the interest paid on deposits and the interest earned on loans, relative to the amount of interest-earning assets with higher net interest margins translating into higher profits

Output:

Majority of Bank's increased their allocation to government securities following the interest rate cap, as opposed to giving out more loans. Barclays Bank had the highest NIM at 9.7%, with the lowest for Stanbic Holdings at 5.2%

2. Return on Average Common Equity - A bank's return on average common equity (ROACE), is the amount of profit the bank earns as a percentage of average common shareholders' equity. It's a profitability measure that shows how much a company generates with the money shareholders have invested

Output:

Banks with higher ROACEs are better at utilizing capital to generate profits. Equity Group has the highest ROACE at 21.6%, while HF Group had the lowest at 1.1%

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

3. Price/Earnings to Growth Ratio - The price/earnings to growth (PEG) ratio is the stock's market price to earnings ratio divided by its growth in earnings for a specified period of time. The PEG ratio is used to determine the value of a stock while taking into account its growth rate, with lower PEG ratios showing the stock is undervalued given the growth in its earnings

Output:

To obtain this ratio, we estimated each bank's 5-year growth rate based on analysis of (i) bank's fundamentals, (ii) projections using each bank's models and (iii) management's input on a bank's strategy going forward. KCB Group had the lowest PEG ratio at 0.7x, while HF Group was the most overvalued at 5.5x

4. Deposits per Branch - A bank's deposits per branch shows the amount of deposits a bank collects from each of its branches, hence a measure of efficiency. Banks with higher deposits per branch are preferred, as it shows for each unit cost of capital expenditure required to open new branches and their subsequent operating costs, a bank receives more in deposits

Output:

Stanbic Holdings has the highest deposits per branch at Kshs 5.5 bn, while NBK had the lowest deposits per branch at Kshs 1.3 bn

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

5. Loans to Deposits Ratio - A bank's loans to deposit ratio (LDR) is a measure of liquidity as it shows how much of a bank's loans are being funded by its deposits. Low LDR ratios indicate that the bank may not be earning a lot of interest. Very high LDR's indicate that the bank might not have enough liquidity to cover any unforeseen funding requirements, and ratios above 1 show that the bank supplemented their loan issues with outside borrowing

Output:

Taking a preferred LDR of 85.0%, we found that KCB Group was closest to the target at 84.6%, while HF Group was the farthest at 135.4%

6. Cost to Income Ratio - The cost to income ratio is a measure of a bank's efficiency, showing its costs in relation to its income. A lower ratio is preferred, as it indicates a bank is more profitable. An increase in the ratio often highlights potential problems as it shows a bank's costs rose faster than its income; while a fall in the ratio could be brought by management's cost cutting measures

Output:

We see many Kenyan banks making an effort to be more efficient. Many banks have opted to restructure, and others have resorted to laying off staff in a bid to bring down costs and subsequently this ratio. I&M Holdings maintained the lowest cost to income ratio of 56.2%, while HF Group had the highest ratio at 92.3%

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

7. Price to Tangible Book Value - This is a valuation ratio that expresses the bank's market price to its tangible book value. It shows the price an investor would pay for a unit amount in the event of a liquidation. A ratio of less than one indicates that the bank's assets are undervalued in the market while a ratio greater than one signifies overvaluation

Output:

We found that HF Group was the most undervalued banks as per this metric at 0.3x, while Equity Group is the most overvalued at 2.5x

8. Tangible Common Equity Ratio - This is the ratio of a bank's common equity less intangible assets to its tangible assets. It is a common indicator of a bank's risk and capitalization and measures how much losses a bank can take before shareholder's equity is wiped out, hence solvency

Output:

I &M Holdings is the most solvent with a tangible common ratio of 18.5%, while NBK was the least solvent at 5.6%

9. Gross non-performing loans ratio - This is a measure of the percentage of a bank's issued loans that are non-performing that is, in default, or close to being in default

Output:

Equity Group had the highest quality loan book with a gross non-performing loans ratio of 6.2%, while NBK had the highest non-performing loans ratio at 40.6%

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

10. Non-Performing Loans Coverage - This is a credit quality metric that measures the credit risks for banks. It shows the extent to which the NPLs are covered by provisions hence the degree of stability of the bank's lending base, with higher ratios preferred

Output:

SCBK has the highest provisions for non-performing loans at 74.4%, while HF Group has the lowest at 36.4%

11. Non-Interest Income to Revenue - The non interest income is the income earned from sources other than loans and investments. The non-interest income to revenue therefore shows the extent of diversification of a bank's operations. High levels are preferred, not exceeding the point where the bank loses focus of its primary business

Output:

We see that Kenyan banks' non-interest income is set to benefit from new initiatives such as banc-assurance and mobile banking. Stanbic Holdings has the highest non-interest income as a percentage of revenue at 44.2%, while DTBK has the lowest at 21.1%

12. Camel Rating - This is a ranking system that assesses the overall condition of a bank, that is, Capital Adequacy, Asset Quality, Management Quality, Earnings Quality and Liquidity. We also incorporated a governance score in the ranking

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Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

13. Corporate Governance Score –This is a ranking system where we analyse 25 metrics to rank listed companies on their corporate governance. Main areas of analysis are in the board composition, audit functions, CEO tenor and evaluation, remuneration and transparency

Output:

The score assumes a diffusion index with 50.0% as the base. Anything below 50.0% should be flagged as having serious corporate governance issues while anything above is skewed towards proper governance. However the variance from 100.0% gives the risk associated with corporate governance

B. Tier I Banks

Tier 1 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
Equity Group	• The digitization strategy of the Bank, with the roll out of Eazzy Banking App and Equitel, which is currently the 2nd largest mobile money transfer service	• Expansion Setbacks: Equity bank has encountered some setback in their regional expansion, having shut down most of its branches in South Sudan
KCB Group	• KCB Mpesa, is expected to be a key growth driver in terms of deposits and loans • Alternative channels including mobile banking and agency banking	• Exposure to different political, economic and regulatory environments especially the impact of South Sudan operation
Co-op Bank	• It has a large Sacco banking base, and the opportunity to grow upon the model • Increased operational efficiency and cost reduction due to its recent transformation project	• Exposure to different political, economic and regulatory environments especially the impact of South Sudan operation
Standard Chartered	• Custody business will continue providing the bank with a niche when it comes to wholesale banking • Strong in corporate banking business	• High NPLs have affected their revenues but adoption of prudent screening criteria is bound to address this • Limited to Kenya as the parent company prefers to operate independently in other markets

Tier 1 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
Barclays Bank	• Barclays has historically enjoyed cheaper funding from its parent company and has not had borrowings historically, this, however might have to change going forward as Barclays Plc exits Africa	• Stiff competition in the retail and SME banking market • The bank will continue lagging its peers in the capture of the retail market • Challenges in loan disbursements as compared to its peers
DTB Bank	• Strong backing from financing partners, i.e. Aga Khan Fund for Economic Development and Habib bank • Driving consolidation in the industry through acquisitions at attractive prices	• Stiff competition in the SME banking market • Exposure to different political, economic and regulatory environments
Stanbic Holdings	• The Corporate and Investment banking is a key driver for revenue as it contributes to a majority of the banks total income • Their mobile banking platform is set to reduce costs associated with branch transactions	• Political Instability in the countries they operate. The instability in S.Sudan proved to be a challenge as it affected their overall income • Their expansion strategy is limited by the presence of Standard Bank in the region

I. Equity Group

Financial Statements Extracts

Equity Bank's PAT is expected to grow at a 5-year CAGR of 13.0%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	41.8	37.6	40.9	47.7	54.7
Non Funded Income	22.2	27.6	30.6	33.8	38.1
Loan Loss Provision	(6.6)	(3.4)	(4.4)	(6.4)	(7.7)
Other Operating Expenses	(32.5)	(34.8)	(37.2)	(41.5)	(46.3)
Total Operating Expenses	**(39.1)**	**(38.3)**	**(41.7)**	**(47.9)**	**(54.0)**
Profit Before Tax	24.9	26.9	29.8	33.6	38.8
Profit After tax	16.6	18.9	20.9	23.5	27.1
% PAT Change YoY	**-4.2%**	**14.0%**	**10.3%**	**12.8%**	**15.3%**
EPS	4.4	5.0	5.5	6.2	7.2
DPS	2.5	2.0	2.0	2.0	2.0
Cost to Income	61.1%	58.7%	58.3%	58.8%	58.2%
NIM	11.1%	8.9%	8.3%	8.8%	8.9%
ROaE	21.5%	21.6%	22.1%	20.6%	20.5%
ROaA	3.7%	3.8%	3.9%	3.8%	3.9%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Net Loans and Advances	266.1	279.1	311.8	357.0	408.8
Government Securities	100.6	128.0	122.5	139.3	159.4
Other Assets	107.1	117.4	150.7	161.0	177.8
Total Assets	**473.7**	**524.5**	**585.0**	**657.2**	**746.0**
Customer Deposits	337.2	373.1	415.8	476.0	545.1
Other Liabilities	54.5	58.2	62.8	58.8	58.9
Total Liabilities	**391.7**	**431.3**	**478.5**	**534.8**	**604.0**
Shareholders Equity	82.0	93.1	106.5	122.4	142.0
Book value Per share	21.7	24.7	28.2	32.4	37.6
% Change in BPS YoY	**13.6%**	**13.6%**	**14.3%**	**15.0%**	**16.0%**

Valuation Summary

Equity Group is fairly valued with a total potential return of 1.5%

Cost of Equity Assumptions:	
Risk free rate *	13.2%
Beta	0.9
Country Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	18.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.4%
Return on Average Equity	21.8%
Terminal P/B	1.8x
Shareholder Equity - FY22e	192.8
Terminal Value-(Year 2022)	354.2

Valuation Summary	Implied Price	Weighting	Weighted Value
Intergrated DDM	65.4	40.0%	26.2
Residual Income	53.2	35.0%	18.6
PBV Multiple	36.1	20.0%	7.2
PE Multiple	47.0	5.0%	2.3

Fair Value	**54.4**
Current Price	**55.5**
Upside/(Downside)	(2.1%)
Dividend Yield	3.6%
Total Potential Return	**1.5%**

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

II. KCB Group

Financial Statements Extracts

KCB Group's PAT is expected to grow at a 5-year CAGR of 11.4%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	47.0	48.4	52.8	59.0	65.2
Non Funded Income	22.5	23.0	23.6	25.5	28.4
Loan Loss Provision	3.8	5.9	5.5	5.9	6.5
Other Operating Expenses	36.6	36.4	40.2	44.3	48.9
Total Operating Expenses	**40.4**	**42.3**	**45.7**	**50.2**	**55.4**
Profit Before Tax	29.1	29.1	30.7	34.2	38.2
Profit After tax	19.7	19.7	21.5	23.9	26.7
% PAT Change YoY	**0.5%**	**-0.1%**	**9.2%**	**11.3%**	**11.6%**
EPS	6.4	6.4	7.0	7.8	8.7
DPS	3.0	3.0	3.1	3.4	3.8
Cost to Income	58.1%	59.2%	59.8%	59.5%	59.2%
ROE	22.2%	19.5%	19.2%	19.2%	19.2%
ROA	3.4%	3.2%	3.2%	3.4%	3.6%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	385.7	422.7	470.4	519.2	570.8
Government Securities	40.5	38.3	45.3	51.0	57.1
Other Assets	169.0	185.7	207.3	213.5	229.8
Total Assets	**595.2**	**646.7**	**722.9**	**783.6**	**857.7**
Customer Deposits	448.2	499.5	553.7	609.1	666.9
Other Liabilities	50.5	41.2	51.2	43.2	44.3
Total Liabilities	498.7	540.7	604.9	652.2	711.3
Shareholders Equity	96.6	106.0	118.0	131.4	146.4
Book value Per share	31.5	34.6	38.5	42.9	47.7
% Change in BPS YoY	**18.8%**	**9.7%**	**11.4%**	**11.4%**	**11.4%**

Valuation Summary

KCB Group is undervalued with a total potential return of 27.0%

Cost of Equity Assumptions:	
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.9
Mature Market Risk Premium	5.2%
Cost of Equity	17.9%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.4%
Return on Average Equity	19.6%
Terminal P/B	1.5x
Shareholder Equity - FY22e	149.8
Terminal Value-(Year 2022)	236.0

Valuation Summary	Implied Price	Weighting	Weighted Value
Residual Income	58.1	35%	20.4
PBV Multiple	59.3	20%	11.9
PE Multiple	63.9	5%	3.2
DDM Integrated	70.7	40%	28.3
Target Price			**63.7**
Current Price			**52.5**
Upside/(Downside)			21.3%
Dividend Yield			5.7%
Total Potential Return			**27.0%**

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

III. Co-operative Bank of Kenya

Financial Statements Extracts

Co-operative Bank's PAT is expected to grow at a 5-year CAGR of 10.3%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	29.5	28.1	28.5	31.1	34.8
Non Funded Income	12.8	13.5	15.1	16.8	18.5
Loan Loss Provision	2.6	3.6	3.3	4.0	4.4
Other Operating Expenses	22.0	21.7	22.5	24.4	26.5
Total Operating Expenses	24.6	25.3	25.8	28.3	31.0
Profit Before Tax	17.7	16.4	17.9	19.6	22.4
Profit After tax	12.7	11.4	12.6	13.7	15.7
% PAT Change YoY	**8.3%**	**-10.0%**	**10.1%**	**9.3%**	**14.1%**
EPS	2.6	2.3	2.6	2.8	3.2
DPS	1.0	1.0	1.0	1.0	1.0
Cost to Income	58.3%	60.9%	59.1%	59.2%	58.2%
NIM	9.9%	9.2%	8.5%	8.0%	8.0%
ROE	22.7%	0.0%	18.1%	16.7%	17.0%
ROA	3.7%	0.0%	3.2%	3.0%	3.1%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Net Loans and Advances	236.9	253.9	280.8	311.1	345.9
Government Securities	37.2	44.0	48.2	54.2	61.2
Other Assets	77.8	89.0	99.7	107.3	116.6
Total Assets	**351.9**	**386.9**	**428.8**	**472.6**	**523.6**
Customer Deposits	260.2	287.4	304.8	341.4	380.7
Other Liabilities	30.6	29.2	45.8	44.0	44.8
Total Liabilities	**290.7**	**316.6**	**350.6**	**385.4**	**425.5**
Shareholders Equity	61.3	69.6	77.4	86.5	97.4
Book value Per share	12.5	14.2	15.8	17.7	19.9
% Change in BPS YoY	**22.1%**	**13.5%**	**11.3%**	**11.7%**	**12.7%**

Valuation Summary

Co-operative Bank is undervalued with a total potential return of 10.8%

Cost of Equity Assumptions:	
Risk free rate *	13.2%
Beta	0.9
Country Risk Premium	5.2%
Extra Risk Premium	0.8%
Cost of Equity	18.6%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.2%
Return on Average Equity	15.9%
Terminal P/B	1.5x
Shareholder Equity - FY22e	124.0
Terminal Value-(Year 2022)	195.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	22.2	40%	8.9
Residual income	19.1	35%	6.7
PBV Multiple	20.1	20%	4.0
PE Multiple	18.7	5%	0.9
Fair Value			**20.5**
Current Price			**19.3**
Upside/(Downside)			6.6%
Dividend Yield			4.1%
Total Potential Return			**10.8%**

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

IV. Standard Chartered Bank

Financial Statements Extracts

Standard Chartered's PAT is expected to grow at a 5-year CAGR of 7.0%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	19.4	18.6	19.0	20.9	22.1
Non Funded Income	8.6	8.8	9.4	9.7	10.5
Loan Loss Provision	2.2	4.2	4.1	4.4	4.8
Other Operating Expenses	12.5	13.1	13.4	14.3	15.3
Total Operating Expenses	**14.7**	**17.3**	**17.5**	**18.7**	**20.1**
Profit Before Tax	13.3	10.1	10.9	11.8	12.6
Profit After tax	9.1	6.9	7.4	8.0	8.6
% PAT Change YoY	**42.7%**	**-23.6%**	**6.7%**	**8.9%**	**6.4%**
EPS	26.3	20.1	21.5	23.4	24.9
DPS	20.0	17.0	17.0	15.2	16.2
Cost to Income	52.5%	63.2%	61.8%	61.3%	61.5%
NIM	9.6%	8.0%	7.5%	7.8%	7.5%
ROaE	21.3%	15.4%	15.9%	16.5%	16.6%
ROaA	3.7%	2.6%	2.5%	2.5%	2.5%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Net Loans and Advances	122.7	126.3	131.1	141.6	157.9
Government Securities	86.9	103.5	116.8	129.8	142.9
Other assets	40.7	55.9	56.2	59.1	59.1
Total Assets	**250.3**	**285.7**	**304.0**	**330.4**	**359.9**
Customer Deposits	186.6	213.3	238.3	262.1	287.0
Other Liabilities	19.8	26.7	18.5	18.2	19.9
Total Liabilities	**206.4**	**240.1**	**256.8**	**280.4**	**306.9**
Shareholders Equity	43.9	45.7	47.2	50.0	53.0
Book value Per share	127.8	132.9	137.4	145.6	154.3
% Change in BPS YoY	**6.4%**	**4.0%**	**3.4%**	**6.0%**	**6.0%**

Valuation Summary

Standard Chartered Bank is over-valued with a total potential return of (12.7%)

Cost of Equity Assumptions:	
Default Spread Adjusted Risk free rate	13.2%
Beta	0.8
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	17.4%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.4%
Return on Average Equity	17.2%
Terminal P/B	1.5x
Shareholder Equity - FY22e	59.7
Terminal Value-(Year 2022)	88.7

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	186.14	40%	74.46
Residual Income	187.85	35%	65.75
PBV Multiple	215.66	20%	43.13
PE Multiple	185.03	5%	9.25

Fair Value	**192.6**
Current Price	**240.0**
Upside/(Downside)	(19.8%)
Dividend Yield	7.1%
Total Potential Return	**(12.7%)**

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

V. Barclays Bank Kenya

Financial Statements Extracts

Barclays Bank Kenya PAT is expected to grow at a 5-year CAGR of 5.1%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	22.3	21.8	22.3	23.7	24.9
Non Funded Income	9.3	8.5	9.1	9.5	10.0
Total Operating Income	**31.7**	**30.3**	**31.4**	**33.2**	**35.0**
Loan Loss Provision	(3.9)	(3.1)	(3.4)	(3.7)	(4.0)
Other Operating Expenses	(16.9)	(16.8)	(17.8)	(19.1)	(20.3)
Total Operating Expenses	**(20.8)**	**(19.9)**	**(21.3)**	**(22.8)**	**(24.3)**
Profit Before Tax	10.9	10.4	10.2	10.3	10.7
Profit After tax	**7.4**	**6.9**	**7.1**	**7.2**	**7.5**
% PAT Change YoY	**-11.9%**	**-6.4%**	**2.8%**	**1.6%**	**3.2%**
EPS	1.4	1.3	1.3	1.3	1.4
DPS	1.0	1.0	1.0	1.0	1.0
Cost to Income	65.7%	65.8%	67.6%	68.9%	69.5%
NIM	10.5%	9.7%	9.5%	9.7%	9.6%
ROaE	18.0%	16.0%	15.8%	15.5%	15.4%
ROaA	3.0%	2.7%	2.8%	2.7%	2.7%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Net Loans and Advances	168.5	168.4	173.6	183.0	196.0
Government Securities	48.7	58.5	59.2	62.7	66.8
Other Assets	42.5	44.3	54.2	52.9	53.3
Total Assets	**259.7**	**271.2**	**287.0**	**298.6**	**316.1**
Customer Deposits	178.2	186.0	197.3	209.1	222.7
Other Liabilities	39.1	41.1	43.9	41.9	43.8
Total Liabilities	**217.3**	**227.1**	**241.2**	**251.0**	**266.5**
Shareholders Equity	42.4	44.1	45.8	47.6	49.6
Book value Per share	7.8	8.1	8.4	8.8	9.1
% Change in BPS YoY	**6.7%**	**4.0%**	**3.8%**	**3.9%**	**4.3%**

Valuation Summary

Barclays Bank Kenya is undervalued with a total potential return of 12.9%

Cost of Equity Assumptions:	
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.9
Mature Market Risk Premium	5.2%
Cost of Equity	19.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.4%
Return on Average Equity	17.3%
Terminal P/B	1.5x
Shareholder Equity - FY22e	53.1
Terminal Value-(Year 2022)	83.6

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	11.1	40%	4.5
Residual Income	16.7	35%	5.8
PBV Multiple	13.9	20%	2.8
PE Multiple	12.2	5%	0.6

Fair Value	**13.7**
Current Price	**13.0**
Upside/(Downside)	5.2%
Dividend Yield	7.7%
Total Potential Return	**12.9%**

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

Cytonn INVESTMENTS

VI. Diamond Trust Bank

Financial Statement Extracts

DTB has an estimated 5-year PAT CAGR of 9.3%

Income Statement	2016	2017	2018f	2019f	2020f
Net Interest Income	19.4	19.7	21.9	23.9	26.8
Non Funded Income	5.1	5.3	5.8	6.4	7.1
Loan Loss Provision	4.3	4.3	5.0	5.6	6.3
Other Operating Expenses	5.8	6.6	7.5	8.2	9.2
Total Operating Expenses	**13.5**	**14.9**	**17.0**	**18.9**	**21.2**
Profit Before Tax	11.0	10.1	10.7	11.5	12.8
Profit After tax	7.7	6.9	7.5	8.0	9.0
% PAT Change YoY	**17.0%**	**-10.3%**	**8.3%**	**7.1%**	**11.6%**
EPS	27.6	24.8	26.8	28.7	32.0
DPS	2.6	2.6	2.8	3.0	3.4
Cost to Income	55.1%	59.6%	61.3%	62.2%	62.3%
NIM	**7.4%**	**6.5%**	**6.5%**	**6.4%**	**6.4%**
ROE	20.5%	13.9%	14.5%	13.7%	13.5%
ROA	2.6%	2.0%	2.0%	1.9%	1.9%
Balance Sheet	**2016**	**2017**	**2018f**	**2019f**	**2020f**
Net Loans and Advances	186.3	196.0	221.7	246.6	274.6
Government Securities	92.8	112.5	115.8	132.5	147.6
Other Assets	49.0	54.7	59.5	62.2	69.0
Total Assets	**328.0**	**363.3**	**396.9**	**441.3**	**491.2**
Customer Deposits	238.1	266.2	298.2	334.0	374.1
Other Liabilities	44.1	43.4	38.4	39.8	41.6
Total Liabilities	**282.2**	**309.7**	**336.6**	**373.7**	**415.7**
Shareholders Equity	41.0	48.4	55.1	62.3	70.3
Book value Per share	146.7	173.0	197.0	222.7	251.4
% Change in BPS YoY	**14.5%**	**17.9%**	**13.9%**	**13.0%**	**12.9%**

Source – Company Financials

Valuation Summary

DTB's stock is undervalued with a total potential return of 31.2%

Cost of Equity Assumptions:	
Risk free rate *	13.2%
Beta	0.8
Country Risk Premium	5.2%
Extra Risk Premium	1.5%
Cost of Equity	18.8%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.9%
Return on Average Equity	13.3%
Terminal P/B	1.5x
Shareholder Equity - FY21e	87.8
Terminal Value-(Year 2021)	138.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	250.5	35.0%	87.7
DDM Integrated	266.3	40.0%	106.5
PBV Multiple	328.3	20.0%	65.7
PE Multiple	260.5	5.0%	13.0

Fair Value	**272.9**
Current Price	**210.0**
Upside/(Downside)	29.9%
Dividend yield	1.2%
Total Potential return	**31.2%**

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

VII. Stanbic Holdings

Financial Statements Extracts

Stanbic Holdings PAT is expected to grow at a 5-year CAGR of 6.0%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	10.9	10.6	10.8	11.0	11.8
Non Funded Income	7.7	8.4	9.8	11.0	12.5
Loan Loss Provision	(1.8)	(2.8)	(3.4)	(3.7)	(4.5)
Total Operating Expenses	**(12.5)**	**(13.7)**	**(14.5)**	**(15.4)**	**(17.0)**
Profit Before Tax	6.0	5.4	6.1	6.6	7.3
Profit After tax	4.4	4.3	4.3	4.6	5.1
% PAT Change YoY	**-9.9%**	**-2.5%**	**-0.6%**	**8.1%**	**10.4%**
EPS	11.2	10.9	10.8	11.7	12.9
DPS	5.3	5.3	5.3	5.3	5.3
Cost to Income	57.9%	57.2%	54.0%	53.0%	51.5%
NIM	5.9%	5.2%	4.5%	4.2%	4.1%
ROaE	11.3%	10.4%	9.7%	10.0%	10.4%
ROaA	2.1%	1.9%	1.6%	1.6%	1.7%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	132.6	143.3	162.9	175.3	192.5
Other Assets	82.1	105.5	115.8	122.4	127.9
Total Assets	**214.7**	**248.7**	**278.7**	**297.6**	**320.3**
Customer Deposits	155.8	193.4	220.7	236.1	252.7
Borrowings	4.0	4.0	4.0	4.0	4.0
Other Liabilities	14.7	8.4	8.8	9.8	12.9
Total Liabilities	**174.5**	**205.8**	**233.5**	**249.9**	**269.6**
Shareholders Equity	40.1	43.0	45.2	47.7	50.8
Book value Per share	101.5	108.7	114.2	120.7	128.4
% Change in BVPS	**4.6%**	**7.0%**	**5.1%**	**5.7%**	**6.4%**

Valuation Summary

Stanbic Holdings is fairly valued with a total potential return of 1.5%

Cost of Equity Assumptions:	
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.8
Mature Market Risk Premium	5.2%
Extra Risk Premium	1.0%
Cost of Equity	18.2%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.4%
Return on Average Equity	10.3%
Terminal P/B	1.0x
Shareholder Equity - FY22e	57.9
Terminal Value-(Year 2022)	60.8

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	91.6	40%	36.6
DDM Integrated	86.1	35%	30.1
PBV Multiple	85.2	20%	17.0
PE Multiple	66.4	5%	3.3

Fair Value	**87.1**
Current Price	**91.0**
Upside/(Downside)	(4.2%)
Dividend Yield	**5.8%**
Total Potential Return	**1.5%**

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

Cytonn INVESTMENTS

C. Tier II Banks

I. National Bank of Kenya

Tier 2 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
National Bank	• Introduction of Islamic Banking and the SME banking units. The SME products inlude Jenga Chama, Jenga Kilimo and Jenga Biashara • The introduction of bancassurance and custodial services has seen the bank diversify its revenue	• Capital ratios are below the regulatory requirement. However, their major shareholders have firm commitments to inject additional capital in order to meet the statutory capital requirements
NIC Bank	• Increased investment in digital platforms, NIC Now and Internet banking • NIC bank has maintained its pole positioning in asset financing and curved a niche in the market	• Traditional SME market now being targeted by Tier 1 banks, hence it's market share is under threat • Exposure to different political, economic and regulatory environments, with their regional business i.e. Tanzania in a loss making position
HF Group	• Vibrant real estate market in Kenya with an annual housing supply which does not satisfy demand • The bank is the market leader in provision of mortgage financing	• Lack of a vibrant mortgage market in Kenya • Competition from larger banks with Mortgage facilities poses a risk for growth • Asset liability mismatch which forces the bank to resort to expensive financing
I&M Holdings	• They have consistently been among the most efficient banks in Kenya from a survey released by Think Business Banking Awards • They have also fully embraced internet bank in Kenya to further help drive their efficiency • Acquisitions are contributing positively to their NFI growth	• They have not been able to aggressively market themselves as a local household bank as Equity, Co-op and KCB • They face stiff competition for clients from larger existing tier 1 bank in the SME and Retail sectors

Financial Statements Extracts

National Bank's PAT is expected to grow at a 5-year CAGR of 5.4%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	7.8	6.7	7.0	8.9	9.4
Non Funded Income	2.9	2.4	2.5	2.9	3.1
Loan Loss Provision	2.4	0.8	0.8	1.9	2.0
Other Expenses	8.2	7.6	7.8	9.0	9.4
Total Operating Expenses	**10.6**	**8.4**	**8.7**	**10.9**	**11.4**
Profit Before Tax	0.1	0.8	0.9	1.0	1.1
Profit After tax	**0.1**	**0.4**	**0.6**	**0.7**	**0.7**
% PAT Change YoY	**-106.2%**	**479.0%**	**48.0%**	**9.7%**	**12.3%**
EPS	0.2	1.2	1.8	2.0	2.2
DPS	-	-	-	-	-
Cost to Income	76.6%	83.2%	82.0%	76.0%	75.4%
NIM	8.2%	7.4%	7.2%	8.3%	8.2%
ROaE	0.8%	5.8%	8.1%	8.2%	8.4%
ROaA	0.1%	0.4%	0.5%	0.5%	0.6%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Net Loans and Advances	55.0	52.4	60.6	64.8	69.4
Government Securities	34.5	35.7	40.9	43.8	46.2
Other Assets	22.5	21.8	18.6	19.6	21.6
Total Assets	112.1	109.9	120.0	128.2	137.2
Customer Deposits	93.9	94.3	101.0	108.0	115.6
Other Liabilities	11.3	8.4	11.2	11.6	12.3
Total Liabilities	105.2	102.6	112.2	119.7	128.0
Shareholders Equity	6.9	7.2	7.8	8.5	9.3
Book value Per share	20.4	21.4	23.1	25.1	27.3
% Change in BVPS	**-37.5%**	**4.7%**	**8.4%**	**8.5%**	**8.8%**

Valuation Summary

National Bank is fairly valued with a total potential return of 4.2%

Cost of Equity Assumptions:	
Default Spread Adjusted Risk free rate	13.2%
Beta	1.1
Mature Market Risk Premium	5.2%
Extra Risk Premium	2.5%
Cost of Equity	21.7%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.9%
Return on Average Equity	5.2%
Terminal P/B	0.5x
Shareholder Equity - FY22e	10.6
Terminal Value-(Year 2022)	5.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
Common Ratio	(0.4)	0.0%	0.0
Residual Income	(0.9)	50.0%	(0.4)
PBV Multiple	8.1	35.0%	2.9
PE Multiple	24.4	25.0%	6.1
Fair Value			**8.6**
Current Price			**8.3**
Upside/(Downside)			4.2%
Dividend Yield			0.0%
Total Potential Return			**4.2%**

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

Cytonn INVESTMENTS

II. NIC Group

Financial Statements Extracts

NIC Group's PAT is expected to grow at a CAGR of 7.0%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	12.2	10.8	12.6	13.6	14.5
Non Funded Income	4.0	4.2	4.4	4.7	5.1
Loan Loss Provision	3.7	3.0	3.8	4.2	4.6
Total Operating Expenses	10.0	9.3	10.9	11.6	12.5
Profit Before Tax	6.2	5.6	6.1	6.6	7.1
Profit After tax	4.3	4.1	4.3	4.6	5.0
% PAT Change YoY	**-3.3%**	**-4.3%**	**3.4%**	**7.8%**	**7.7%**
EPS	6.8	6.5	6.7	7.2	7.8
DPS	1.3	1.0	1.1	1.1	1.1
Cost to Income	61.9%	62.5%	63.9%	63.8%	63.7%
NIM	8.0%	6.3%	6.5%	6.6%	6.5%
ROE	15.5%	12.9%	10.9%	10.0%	9.9%
ROA	2.6%	2.2%	2.0%	2.0%	2.0%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	114.5	119.8	134.5	144.6	162.7
Government Securities	30.5	54.2	55.8	58.0	63.8
Other Assets	24.5	32.2	34.6	37.1	40.7
Total Assets	**169.5**	**206.2**	**224.9**	**239.6**	**267.2**
Customer Deposits	111.8	138.9	152.8	168.1	184.9
Other Liabilities	27.3	32.5	27.3	22.8	29.2
Total Liabilities	**139.1**	**171.5**	**180.1**	**190.9**	**214.1**
Shareholders Equity	29.8	34.2	44.4	48.3	52.5
Book value Per share	6.12	7.03	9.10	9.91	10.78
% Change in BVPS	**15.4%**	**14.8%**	**29.5%**	**8.8%**	**8.9%**

Valuation Summary

NIC Group is undervalued with a total potential return of 42.3%

Cost of Equity Assumptions:	
Risk free rate *	13.2%
Beta	0.9
Country Risk Premium	5.2%
Cost of Equity	18.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.4%
Return on Average Equity	9.8%
Terminal P/B	1.3x
Shareholder Equity - FY22e	46.4
Terminal Value-(Year 2022)	60.9

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	67.5	40%	27.0
Residual Valuation	54.3	35%	19.0
PBV Multiple	63.9	20%	12.8
PE Multiple	56.6	5%	2.8
Fair Value			**61.6**
Current Price			**44.0**
Upside/(Downside)			40.0%
Dividend Yield			2.3%
Total Potential Return			**42.3%**

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

Cytonn INVESTMENTS

III. I&M Holdings

Financial Statements Extracts

I&M Holdings PAT is expected to grow at a 5-year CAGR of 7.7%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	15.5	15.6	16.3	17.6	19.7
Non Funded Income	5.2	5.8	5.4	5.9	6.4
Total Operating Income	**20.8**	**21.3**	**21.7**	**23.5**	**26.1**
Loan Loss Provision	3.0	4.1	3.5	3.8	4.0
Other Operating Expenses	7.2	7.8	8.4	8.8	9.6
Total Operating Expenses	**10.2**	**12.0**	**11.9**	**12.5**	**13.6**
Profit Before Tax	10.6	9.9	10.4	11.5	13.1
Profit After tax	7.8	7.3	7.3	8.1	9.2
EPS	**19.8**	**18.5**	**18.5**	**20.6**	**23.4**
% PAT Change YoY	**8.6%**	**-6.4%**	**-0.2%**	**11.3%**	**13.8%**
EPS	19.8	18.5	18.5	20.6	23.4
DPS	3.5	3.5	3.5	3.5	3.5
CIR	34.7%	36.8%	38.5%	37.3%	36.6%
NIM	8.6%	7.8%	7.3%	7.1%	7.3%
ROaE	22.7%	17.9%	15.3%	15.1%	15.1%
ROaA	3.9%	3.2%	2.9%	2.9%	3.1%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Investment Securities	45.8	50.8	59.0	70.2	75.6
Net Loans and Advances	134.7	153.0	169.4	180.3	192.0
Other Assets	30.1	36.2	38.6	39.4	44.3
Total Assets	**210.5**	**240.1**	**267.0**	**289.9**	**311.9**
Customer Deposits	146.5	169.3	190.3	204.9	220.7
Other Liabilities	24.5	23.8	23.8	25.4	23.8
Total Liabilities	**171.0**	**193.1**	**214.1**	**230.3**	**244.5**
Shareholders Equity	37.0	44.3	50.2	56.9	64.7
Book value Per share	0.1	0.1	0.1	0.1	0.2
% BVPS Change YoY	**17.7%**	**19.7%**	**13.3%**	**13.3%**	**13.7%**

Cytonn INVESTMENTS

Valuation Summary

I&M Holdings is undervalued with a total potential return of 19.9%

Cost of Equity Assumptions:	
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.9
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.5%
Cost of Equity	18.3%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.9%
Return on Average Equity	13.5%
Terminal P/B	1.3x
Shareholder Equity - FY22e	82.6
Terminal Value-(Year 2022)	108.4

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	178.41	40%	71.4
Residual income	152.87	35%	53.5
PBV Multiple	96.55	20%	19.3
PE Multiple	145.49	5%	7.3
Fair Value			**151.2**
Current Price			**129.0**
Upside/(Downside)			17.2%
Dividend yield			2.7%
Total Potential Return			**19.9%**

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

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IV. HF Group

Financial Statements Extracts

HF Group's PAT is expected to grow at a 5-year CAGR of 5.5%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	3.9	3.0	2.6	2.1	2.2
Non Funded Income	0.8	1.3	1.5	1.8	2.1
Loan Loss Provision	(0.7)	(0.6)	(0.7)	(0.7)	(0.7)
Other Operating Expenses	(2.6)	(3.4)	(3.3)	(3.1)	(3.3)
Total Operating Expenses	**(3.3)**	**(4.0)**	**(4.0)**	**(3.8)**	**(4.1)**
Profit Before Tax	1.4	0.3	0.1	0.1	0.1
Profit After tax	0.9	0.1	0.1	0.1	0.1
% PAT Change YoY	**-24.3%**	**-86.1%**	**-21.6%**	**-5.6%**	**3.6%**
EPS	0.0	0.0	0.0	0.0	0.0
DPS	0.5	0.1	0.1	0.1	0.1
Cost to Income	56.3%	78.9%	79.9%	79.8%	79.1%
NIM	6.5%	5.2%	4.6%	3.9%	3.8%
ROaE	8.3%	1.1%	0.9%	0.8%	0.8%
ROaA	1.3%	0.2%	0.1%	0.1%	0.1%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	54.5	49.6	50.2	51.8	54.1
Government Securities	4.1	2.3	2.9	1.9	2.2
Other Assets	13.4	15.6	16.4	17.6	17.9
Total Assets	**71.9**	**67.5**	**69.4**	**71.3**	**74.3**
Customer Deposits	38.1	36.7	38.1	40.2	42.4
Other Liabilities	22.6	19.4	19.8	19.5	20.1
Total Liabilities	**60.6**	**56.1**	**57.9**	**59.7**	**62.6**
Shareholders Equity	11.3	11.4	11.5	11.6	11.7
Book value Per share	0.0	0.0	0.0	0.0	0.0
% Change in BPS YoY	**6.3%**	**1.4%**	**0.7%**	**0.6%**	**0.7%**

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Valuation Summary

HF Group is overvalued with a negative total potential return of 6.4%

Cost of Equity Assumptions:	
Default Spread Adjusted Risk free rate	13.2%
Beta	0.9
Mature Market Risk Premium	5.2%
Extra Risk Premium	1.5%
Cost of Equity	19.3%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.9%
Return on Average Equity	1.4%
Terminal P/B	0.6x
Shareholder Equity - FY22e	11.9
Terminal Value-(Year 2022)	7.5

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	10.2	40.0%	4.1
Residual Income	11.3	35.0%	4.0
PTBV Multiple	12.8	20.0%	2.6
PE Multiple	7.3	5.0%	0.4
Fair Value			**11.0**
Current Price			**12.5**
Upside/(Downside)			(9.3%)
Dividend Yield			2.9%
Total Potential return			**(6.4%)**

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

Feedback Summary

During the preparation of this FY'2017 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 Kenya	Yes	Yes
Co-operative Bank of Kenya	Yes	Yes
KCB Group	Yes	Yes
NIC Group	Yes	Yes
National Bank of Kenya	Yes	Yes
Standard Chartered Bank Kenya	Yes	Yes
Housing Finance Group	Yes	Unresponsive
Stanbic Holdings	Yes	Unresponsive
I&M Holdings	Yes	Unresponsive
Barclays Bank of Kenya	Yes	Unresponsive
Equity Group Holdings	Yes	Unresponsive

Thank You!

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