Kenya Listed Commercial Banks Review
Cytonn H1'2019 Banking Sector Report

"Consolidation and Revenue Diversification to Drive Growth in the Kenyan Banking Sector"

Cytonn

Sunday, 29th September 2019

I. Introduction to Cytonn

About Us

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

82 Over Kshs. 82 billion worth of projects under mandate

7 Seven offices across 2 continents

500 Over 500 staff members, including Cytonn Distribution

10 10 investment ready projects in real estate

A unique franchise differentiated by:

Independence & Investor Focus

Focused on serving the interest of clients, which is best done on an independent platform to minimize conflicts of interest

Alternative Investments

Specialized focus on alternative assets - Real Estate, Private Equity, and Structured Solutions

Strong Alignment

Every staff member is an owner in the firm. When clients do well, the firm does well; and when the firm does well, staff do well

Committed Partners

Strong global and local partnerships in financing, land and Cytonn Real Estate, our development affiliate

Why We Exist

Africa presents an attractive investment opportunity for investors seeking attractive and long-term returns. Despite the alternative markets in Africa having high and stable returns, only a few institutional players serve the market. Cytonn is focused on delivering higher returns in the alternative markets, while providing the best client service and always protecting our clients' interests.

WE SERVE THREE MAIN CLIENT SEGMENTS:

- High Net-worth Individuals through Cytonn Private Wealth. This is done through our captive Distribution Network
- East Africans in the Diaspora through Cytonn Diaspora
- Global and Local Institutional Clients. These clients are served from our Investment & Fundraising Team

WE INVEST OUR CLIENT FUNDS IN:

- Real Estate, and Real Estate Related Businesses
- Private Equity
- Fixed Income Structured Solutions
- Equities Structured Solutions

We collect funds from our clients

We invest them in high growth opportunities

We deliver the best possible returns

Our Business Structure

Cytonn Investments Management Plc

- **Cytonn Capital Partners** (Private Markets)
  - Private Offers and Real Estate Investments
  - Cytonn Hospitality
  - Cytonn Education Services
  - Superior Homes Kenya
  - Serviced Offices
- **Cytonn Asset Managers** (Regulated by Capital Markets Authority)
  - Unit Trust Funds
  - Cytonn Africa Financial Fund
  - Cytonn Advisory
  - Pension Fund Management
- **Cytonn Real Estate**
  - Research and Deal Origination
  - Project Management
  - Quality Assurance/ Control
  - Cytonn Procurement - Cymatt
  - Cytonn Real Estate Legal
  - Cytonn Properties
  - Cytonn Centre for Affordable Housing
- **Other Strategic Initiatives**
  - Cytonn Distribution
  - East African Forum for Alternative Investments

Board of Directors

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

Board of Directors

Governance: Board Committees

Investments and Strategy Committee

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

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

Audit, Risk and Compliance Committee

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

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

Human Resources, Governance & Compensation Committee

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

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

Technology and Innovation Committee

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

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

Management Team

Edwin H. Dande, MBA
Managing Partner & CEO

Elizabeth N. Nkukuu, CFA
Chief Investments Officer

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

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

Victor Odendo, MBA
Principal Officer, CAML

Daniel N. Mainye, MBA
Business Manager, Technologies

Anne Joseph, BA, CHRM
Assistant HR Manager

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

Management Team Cont..

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

Samuel Ng'ang'a
Finance Manager

Cytonn's Business Overview

Where we Raise Money

- Local High-net-worth Investors via a captive distribution of 250 Financial Advisors and 300 Independent Financial Advisors
- Global & Local Institutions such as Taaleri of Finland
- Diaspora via our office in the Washington DC Metro Area
- Retail & Pension via Cytonn Asset Managers

Where we Invest

- **Real Estate –** 84.8%
- **Financial Services** - 4.6%
- **Education** – 0.8%
- **Hospitality -** 9.8%
- **Procurement –** Just Started

How we Exit

- **Individuals i.e. Cytonn Distribution**
- **Institutions**
- **Investment Vehicles**
  - Partnership Units (LLP)
  - REIT's Fund
  - Other Income Funds

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

II. Kenya Economic Review and Outlook

Kenya Economic Review

Of the 7 indicators we track, 3 are positive and 4 are neutral. We maintain our positive outlook on the 2019 macroeconomic environment

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicators	**YTD 2019 Experience and Outlook Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
GDP Growth	• In Q1'2019, the country's economic activity experienced relatively slower growth, expanding by 5.6%, in line with the 5-year average growth rate of 5.4%, but slower compared to the 6.5% growth recorded in Q1'2018 • In 2019, GDP growth is projected to range between 5.7%-5.9%, lower than the 6.3% growth in 2018, but higher than the 5-year historical average of 5.4%, driven by; i. Growth in the agriculture sector, ii. Implementation of the Big 4 Agenda projects by the Kenyan Government and, iii. Recovery in the business environment evidenced by the Stanbic Bank Monthly Purchasing Manager's Index (PMI), which rose to 54.3 in May 2019 from 51.3 recorded in April, an indication of improving business conditions	**Positive**	**Positive**
Inflation	• The average inflation rate increased to an average of 5.2% in H1'2019, as compared to 4.3% in H1'2018, a hike attributable to delayed rainfalls at the beginning of the year. • We expect inflation to remain within the government target range of 2.5% - 7.5%, with inflationary pressure expected to emanate from the effects of the rise in electricity tariffs and fuel prices	**Positive**	**Positive**

Source – KNBS

Kenya Economic Review, continued…

Of the 7 indicators we track, 3 are positive and 4 are neutral. We maintain our positive outlook on the 2019 macroeconomic environment

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicators	**YTD 2019 Experience and Outlook Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
Government Borrowing	• We remain neutral on domestic borrowing, due to the levels of domestic debt maturities in FY'2019/20 currently at Kshs 748.5 bn, coupled with the historical underperformance of ordinary revenues, with the Government having met 93.1% of its target as per the FY'2018/2019 budget outturn • Despite the underperformance, the Government raised its total revenue target by 14.2% to Kshs 2.1 tn for FY'2019/20 which we doubt it will meet, thus exert slight pressure on the domestic borrowing front to plug in the deficit	**Neutral**	**Neutral**
Exchange Rate	• We expect the Kenyan Shilling to remain relatively stable against the dollar, supported by; i. CBK's activities in the money market, such as repurchase agreements and selling of dollars, ii. High levels of forex reserves, currently at USD 9.0 bn (equivalent to 5.6-months of import cover) iii. Improving diaspora remittances, which have increased cumulatively by 8.9% in the 12-months to August 2019 to USD 2.8 bn, from USD 2.6 bn recorded in a similar period of review in 2018	**Neutral**	**Neutral**

Source – CBK

Kenya Economic Review, continued…

Of the 7 indicators we track, 3 are positive and 4 are neutral. We maintain our positive outlook on the 2019 macroeconomic environment

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicators	**YTD 2019 Experience and Outlook Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
Interest Rates	• The interest rate environment has remained stable in 2019, with the CBR having been retained at 9.0% in the 4 MPC meetings held in 2019. • With the heavy domestic maturities in 2019, we expect slight upward pressure on interest rates going forward, as the government tries to meet its domestic borrowing targets for the 2019/2020 fiscal year	**Neutral**	**Neutral**
Investor Sentiment	• The May 2019 Kenya Eurobond issue was 4.5x oversubscribed partly showing the appetite for Kenyan securities by the foreign community, and investor confidence in Kenya's stable and relatively diversified economy • We expect improved foreign inflows from the negative position in 2018, mainly supported by long-term investors who enter the market looking to take advantage of the current cheap valuations in select sections of the market	**Neutral**	**Neutral**
Security	• The political climate in the country has eased. Despite the terror attack experienced during the first half of 2019, Kenya was spared from travel advisories, evidence of the international community's confidence in the country's security position	**Positive**	**Positive**

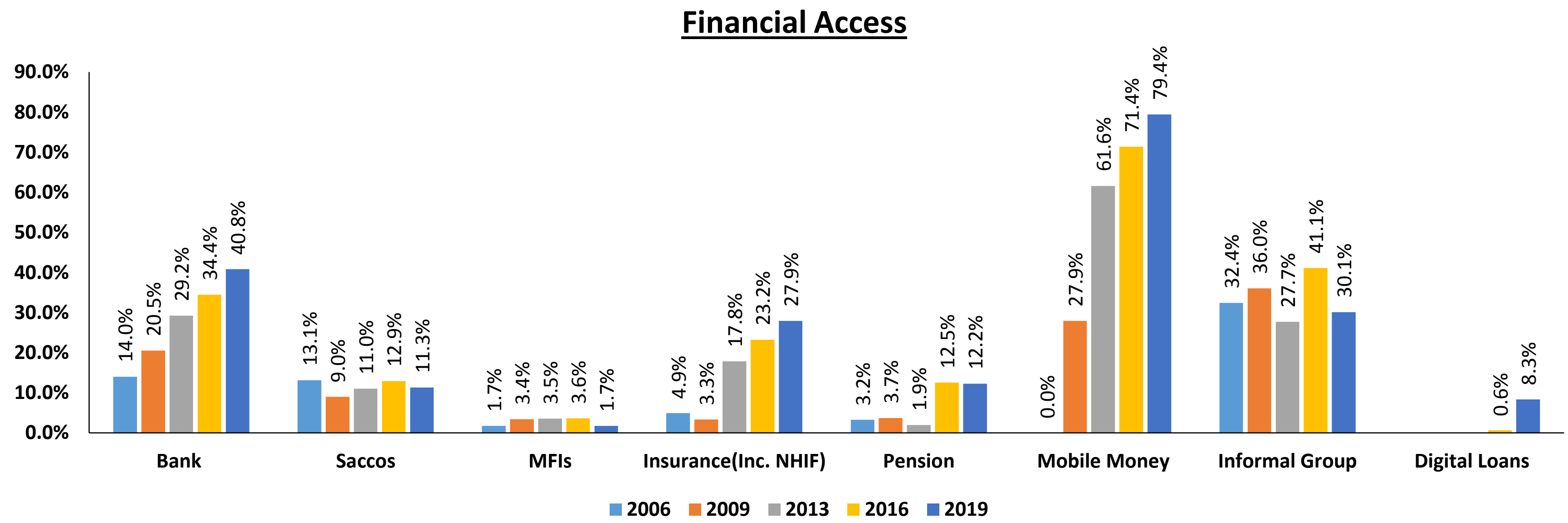
Source – CBK

III. Banking Sector Overview

Kenya Banking Sector Overview

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

- In Kenya there are a total of 40 commercial banks, with Charterhouse Bank under statutory management and Imperial Bank under receivership, 1 mortgage finance company, 13 microfinance banks, 9 representative offices of foreign banks, 73 foreign exchange bureaus, 19 money remittance providers and 3 credit reference bureaus
- Financial inclusion in Kenya has continued to rise, with 82.9% of the adult population able to access formal financial services. This has largely been driven by digitization, with Mobile Financial Services (MFS), transfer and lending, rising to be the preferred method to access financial services in 2019, with 79.4% of the adult population using the channel



Source: Central Bank of Kenya, FinAccess report

Recent Developments in the Kenyan Banking Sector

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

1. **Consolidation:** Kenya's banking sector has witnessed heightened M&A activity over the last 4 years. Most recently, The Central Bank of Kenya approved the proposed merger between lenders NIC and CBA where effective 1st October 2019, all subsidiaries will operate under NCBA Group Plc, a Non-Operating Holding Company. Below is a summary of key transactions done over the last five years and their transaction multiples. It is worth noting that a majority of transactions are happening at relatively cheaper multiples compared to historical levels.

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs bns)	Transaction Stake	Transaction Value (Kshs bns)	P/Bv Multiple	Date
CBA Group	NIC Group	33.5**	53:47***	23.0	**0.7x**	27-Sept
Oiko Credit	Credit Bank	3	22.8%	1	**1.5x**	29-Aug
KCB Group	National Bank of Kenya	7	100.0%	6.6	**0.9x**	19-Apr*
CBA Group	Jamii Bora Bank	3.4	100.0%	1.4	**0.4x**	19-Jan*
AfricInvest Azure	Prime Bank	21.2	24.2%	5.1	**1.0x**	19-Jan
KCB Group	Imperial Bank	Unknown	Undisclosed	Undisclosed	**N/A**	18-Dec
SBM Bank Kenya	Chase Bank ltd	Unknown	75.0%	Undisclosed	**N/A**	18-Aug
DTBK	Habib Bank Kenya	2.4	100.0%	1.8	**0.8x**	17-Mar
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	**1.6x**	16-Nov
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	**1.4x**	16-Jun
I&M Holdings	Giro Commercial Bank	3	100.0%	5	**1.7x**	16-Jun
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	**2.3x**	15-Mar
Centum	K-Rep Bank	2.1	66.0%	2.5	**1.8x**	14-Jul
GT Bank	Fina Bank Group	3.9	70.0%	8.6	**3.2x**	13-Nov
Average			**73.7%**		**1.4x**	

Recent Developments in the Kenyan Banking Sector

The Finance Bill 2019 proposing the repeal of the rate cap law was opposed, whilst the government conducting demonetization process expected to be concluded by 1st Oct 2019

2. Regulation:

i. **Finance Bill 2019-** During the period under review, the Finance Bill 2019 was introduced to the National Assembly with a proposal to repeal the law capping interest rates. The National Assembly, through the Committee on Finance and National Planning opposed the National Treasury's proposal to repeal the interest rate cap law by amending the Finance Bill 2019 and re-introduced the provisions on capping interest rates charged on loans. Currently, the Finance Bill 2019 is at the Presidential Assent stage

ii. **IFRS 9-** With the implementation of IFRS 9, which took effect from 1st January 2018, banks were expected to provide both for the incurred and expected credit losses. The CBK had given commercial banks a one year earnings protection window for the implementation of the IFRS 9 to charge the higher provisions against the retained earnings in the balance sheet and not on the profit and loss account. The banking industry is bracing for its full effects in 2019, expecting reduced profitability and an eroded capital base as a result of increased provisioning,

iii. **Demonetization:** The Central Bank of Kenya (CBK), in a gazette notice dated 31st May 2019, launched new generation notes of denominations Kshs 1,000, Kshs 500, Kshs 200, Kshs 100 and Kshs 50 aimed at tackling illegal financial flows. The regulator further highlighted that all the old Kshs 1,000 bank notes in circulation, valued at Kshs 217.6 bn, will cease to be legal tender and be withdrawn from the market by 1st October 2019, in a bid to fight illegal financial flows

Recent Developments in the Kenyan Banking Sector

CBK and various banks launched their SME-focussed lending programs, with the launch of the Stawi facility being the key highlight

3. SME-Focussed Lending:

i. The Central Bank of Kenya (CBK) launched a loan facility dubbed as 'Stawi' targeting Micro Small and Medium Enterprises (MSMEs), enabling businesses to access unsecured loans ranging from Kshs 30,000 to Kshs 250,000 from five commercial banks (NIC Group, KCB Group, Diamond Trust Bank Kenya (DTBK), Co-operative Bank Kenya and Commercial Bank of Africa (CBA)), with a repayment period of between 1 – 12 months. Priced at 9.0% p.a, the credit product will help address MSMEs challenges such as access to formal credit because of the informal nature of their businesses and lack of collateral, amid low private sector credit growth rate,

ii. The African Guarantee Fund (AGF) set aside USD 170.0 mn (Kshs 17.1 bn) with an aim to back Kenyan Banks to enable them to lend to MSMEs. AGF committed to guarantee half the value of a loan balance to a single MSME borrower or half the value of an outstanding MSME loan portfolio, charging banks a fee ranging between 1.5%- 3.0% for the risk guarantee, and

iii. Additionally, Equity Bank Kenya acquired a syndicated loan worth Kshs 10.0 bn from the International Finance Corporation (IFC) in order to extend loans to MSMEs and climate friendly investors, in a bid to deepen financial inclusion and boost sustainable investments in Kenya

Growth in the Banking Sector

Listed banks' H1'2019 EPS increased by 9.0% y/y, from an average increase of 19.0% witnessed in H1'2018

- Kenya's listed banks recorded a core EPS growth of 9.0% in H1'2019, slower than the 19.0% growth recorded in H1'2018. The performance highlights the banking sectors' continued resilience and profitability. The relatively slower performance may be attributed to a strong performance in H1'2018, with the sector coming from a low performance base in H1'2017
- The performance was supported by a 3.8% increase in Net Interest Income (NII) coupled with a 16.5% growth in Non-Funded Income (NFI). The Net Interest Margin (NIM) decreased to 7.7% in H1'2019 from 8.1% in H1'2018, highlighting the decline in average yields on interest earnings assets, owing to increased allocation to relatively lower yielding Government securities
- The sector continued to record an improvement in operating efficiency as the Cost to Income Ratio (CIR) improved to 48.8% in H1'2019, from 49.7% in H1'2018, as benefits of cost rationalization measures such as branch closures, staff layoffs in voluntary retirement plans kicked in, and digitization strategies aimed at reducing operational costs
- Listed banks recorded an improved 9.8% growth in net loans and advances in H1'2019, from a growth of 3.8% recorded in H1'2018, indicating banks may have relaxed their stringent credit policies, as they focused on corporate and secured lending
- Profitability recorded a slight decline, as indicated by the drop in the Return on Average Equity to 19.3% from 19.5% in H1'2018

Banking Sector Growth Drivers

Alternative channels of transactions, revenue diversification and regional expansion remain the key growth drivers for banks

1. **Increased adoption of technology-** Banks have been riding on the digital revolution wave to improve their operational efficiency. Increased adoption of alternative channels of transactions such as mobile, internet and agency banking, has led to increased transactions carried out via alternative channels and out of bank branches, which have been reduced to handling high value transactions and other services such as advisory. Thus banks reduced front-office operations, thereby reducing the staff required and by extension reducing operating expenses and hence improving operational efficiency

2. **Revenue Diversification-** Banks have continued to diversify their revenue sources, as they adapt to operating under the interest rate cap regime. Banks increased the fees and commissions on loans and ventured into various NFI growth ventures such as bancassurance, brokerage, and fleet management. NFI was also earned from transactional income obtained as the number of transactions increased buoyed by increased adoption of alternative channels of transactions

3. **Regional expansion-** Kenyan banks continued to pursue their inorganic growth strategies beyond Kenya, with a key example being Equity Group Holdings, who entered into a binding term sheet with Atlas Mara Limited to acquire certain banking assets in 4 countries in exchange for shares in Equity Group. Atlas Mara is exiting four markets namely Rwanda, Zambia ,Tanzania and Mozambique. Also, the bank announced that it had entered into an agreement to acquire a majority stake in Banque Commercial du Congo (BCDC, subject to shareholder and regulatory approvals). The bank’s plan is to enter new markets through a combination of acquisitions and setting up of fresh operations such as in Ethiopia

Consolidation and Revenue Diversification to drive Growth

Focus Area	Summary	Effect on Banking Sector
Regulation	• **Finance Bill 2019:** The National Assembly opposed the proposal by the National Treasury in the Finance Bill 2019 to repeal the law capping interest rates	• Net Interest Margins remain compressed as downward revisions of CBR compress yields on loans • Reduced profitability and eroded capital base as a result of increased provisioning
Diversification	• **Revenue Diversification:** Banks continued their focus on diversifying their revenue sources, targeting transactional fee income, as well as increased income from non-banking subsidiaries	• Consistent relatively strong profitability growth, which has alleviated the effects of a relatively slow funded income growth
Consolidation	• **Increase in Mergers & Acquisitions:** With increased competition amongst players in the banking sector, coupled with tough operating environment, several consolidation activity has happened.	• Consolidation in the sector have resulted in (i) aiding in successful remediation of collapsed banks, (ii) leaving fewer but well capitalized players able to catalyze economic growth, thus creating a more stable banking sector
Asset Quality	• **Increase in Non-Performing Loans:** With the Gross NPL ratio currently at 10.0%, up from 9.8% in H1'2018, and much higher than the 5-year average of 8.0%. This raises concerns around asset quality in the sector	• The increased NPLs and adoption of IFRS 9 has forced banks to adopt a more stringent risk assessment framework, to effectively reduce financial impairments and consequently the provisioning requirements required under the new reporting standard, leading to reduced credit extension

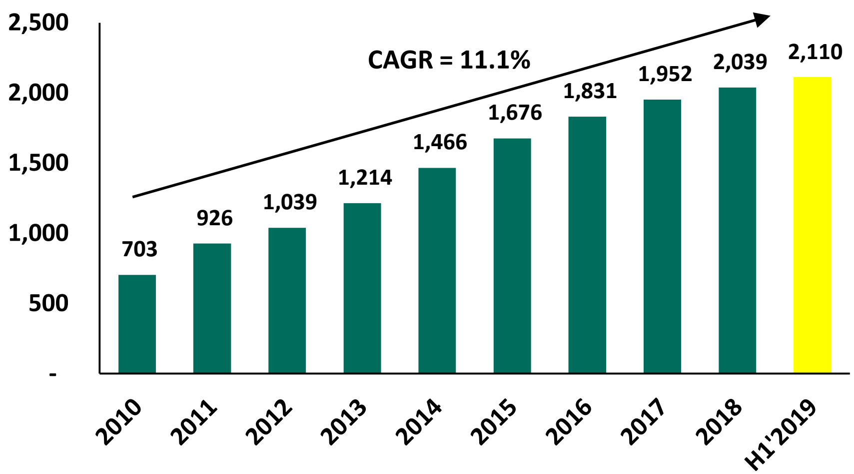
The Banking sector maintained its growth trajectory largely aided by recovery in funded income as well as a relatively stronger growth in NFI. Increased usage of alternative channels improves operational efficiency as well as expanding Non-Funded Income. Deteriorating asset quality remains a concern,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

III. Listed Banking Sector Metrics

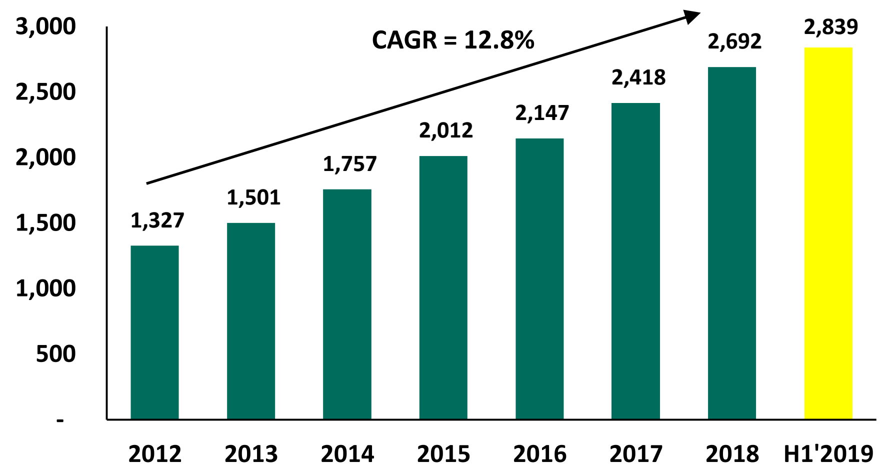
Listed Banking Sector Metrics

Deposit growth has remained strong, faster than the growth in loans and advances. The number of branches has grown slower by 6.4%, with 2 branches closed in H1'2019

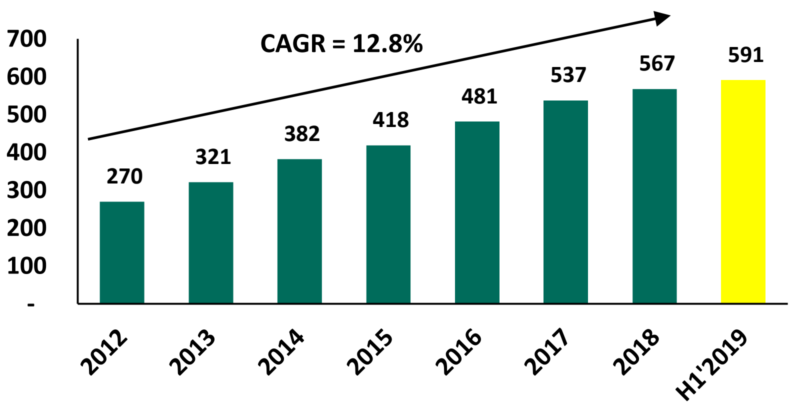
Loans and Advances (Kshs Bn)



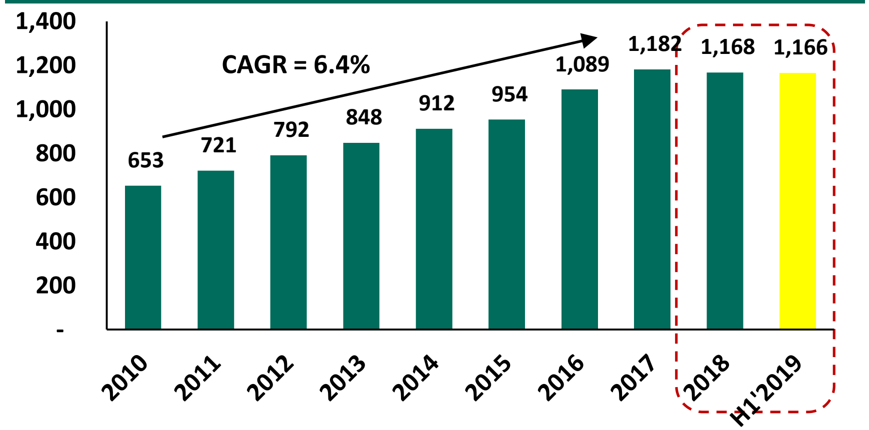
Deposits (Kshs Bn)



Shareholders Equity (Kshs Bn)



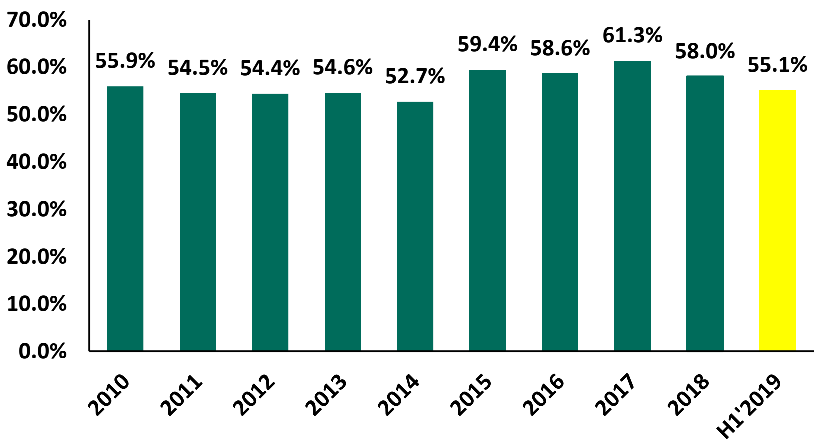
Bank Branches



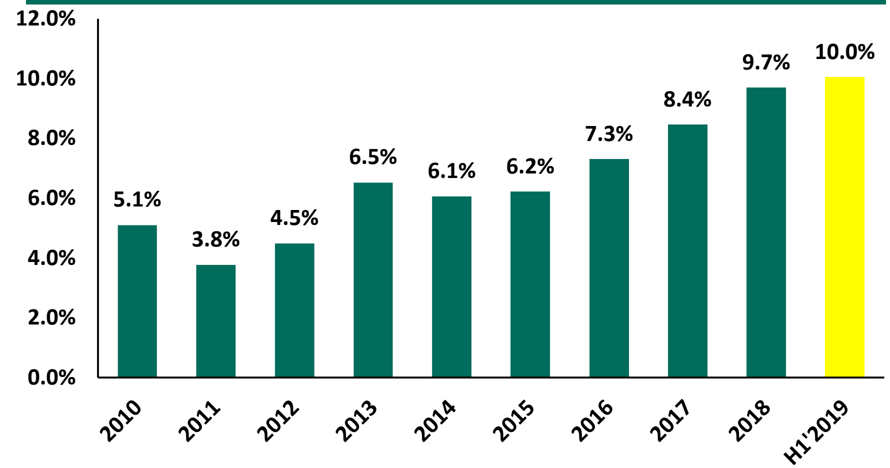
Listed Banking Sector Metrics

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

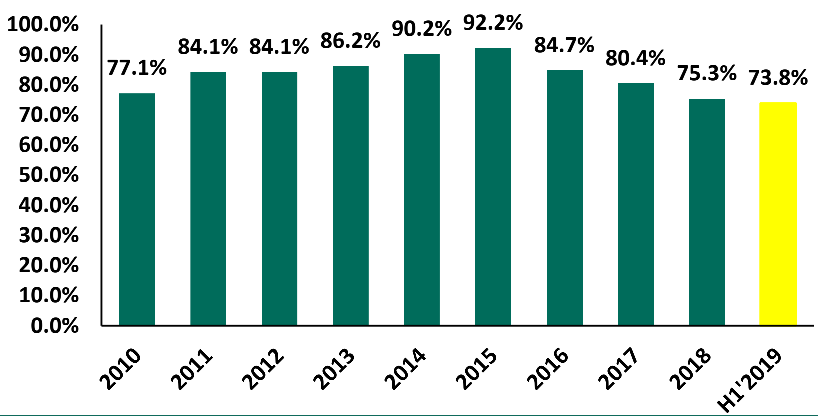
Cost to Income Ratio



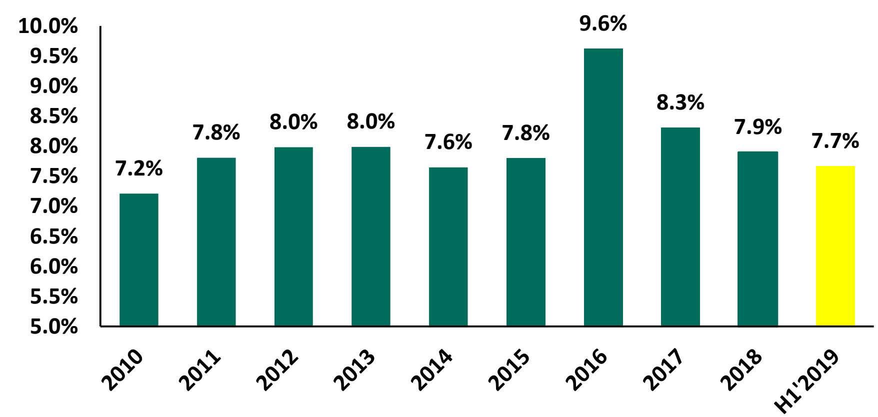
NPL Ratio



Loan to Deposit Ratio



Net Interest Margin



Listed Banking Earnings and Growth Metrics

Kenya's listed banking sector H1'2019 core EPS increased by 9.0%, slower compared to a growth of 19.0% in H1'2018

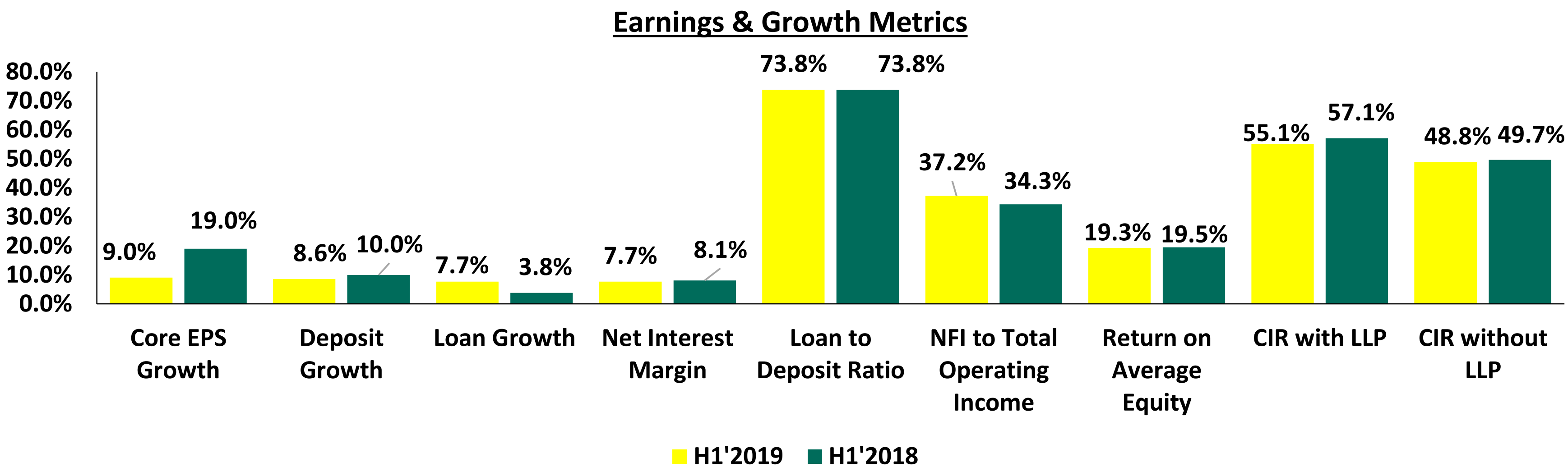
Bank	Core EPS Growth	Net Interest Margin	NFI to Total Operating Income	Deposit Growth	Growth In Govt Securities	Loan Growth	LDR	Return on Average Equity
Barclays Bank	18.0%	8.4%	32.4%	5.9%	15.4%	6.0%	81.3%	18.1%
I&M Holdings	17.0%	6.0%	39.3%	12.5%	28.5%	5.7%	72.6%	17.7%
Stanbic Bank	14.4%	5.1%	47.8%	10.3%	8.1%	15.0%	74.4%	15.3%
DTBK	11.0%	6.0%	24.5%	0.5%	(6.5%)	(3.8%)	67.4%	13.9%
Equity Bank	9.1%	8.5%	44.0%	16.5%	13.0%	16.7%	70.0%	22.1%
NIC Bank	8.6%	6.0%	32.5%	3.5%	8.1%	3.1%	77.8%	12.0%
SCBK	5.4%	7.6%	32.4%	(1.0%)	(15.5%)	7.4%	52.5%	18.2%
KCB Group	5.0%	8.2%	34.1%	7.3%	20.3%	13.6%	85.0%	22.7%
Coop Bank	4.6%	8.5%	38.0%	9.0%	13.6%	2.6%	79.6%	18.8%
NBK	(40.1%)	8.2%	19.4%	(4.9%)	(17.5%)	(1.0%)	51.8%	6.7%
HF Group	N/A	4.0%	47.1%	(6.6%)	5.4%	(14.8%)	91.0%*	6.1%
H1'2019 Weighted Average**	**9.0%**	**7.7%**	**37.2%**	**8.6%**	**12.1%**	**9.8%**	**73.8%**	**19.3%**
H1'2018 Weighted Average	**19.0%**	**8.1%**	**34.3%**	**10.0%**	**14.9%**	**3.8%**	**73.8%**	**19.5%**

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

** *The weighted average is based on market capitalization as at 6st Sept 2019*

Listed Banks Earnings and Growth Metrics Cont…

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



- Loan growth continued to improve in H1’2019, compared to H1’2018, with no change in the loan to deposit ratio mitigated by the slower deposit growth in H1’2019
- Increased focus on cost rationalization is bearing fruit, as operational efficiency continues to improve, as shown by the improvements in cost to income without LLP
- Strong NFI growth and cost rationalization continue to support growth, with profitability recording a growth amid a relatively tough operating environment

Listed Banks Operating Metrics

Non Funded Income currently contributes 37.2% of banks' total operating income, up from 34.3% in H1'2018, owing to the recovery in NFI after implementation of EIR in 2018

Bank	Deposit/Branch (bn)	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non Funded Income/Revenue
Stanbic Bank	9.2	9.6%	57.5%	12.0%	47.8%
HF Group	1.5	22.1%	53.2%	15.6%	47.1%
Equity Group	1.6	8.8%	44.6%	15.0%	44.0%
I&M Holdings	5.8	13.0%	62.4%	15.2%	39.3%
Coop Bank	2.1	11.2%	51.4%	16.0%	38.0%
KCB Group	2.2	7.8%	52.7%	15.5%	34.1%
NIC Bank	2.9	14.3%	44.5%	16.7%	32.5%
Barclays Bank	2.6	7.9%	72.5%	11.8%	32.4%
SCBK	6.9	14.6%	75.9%	15.2%	32.4%
DTBK	2.1	7.6%	50.3%	14.8%	24.5%
NBK	1.3	48.1%	61.8%	5.4%	19.4%
Weighted Average H1'2019*	**3.3**	**10.0%**	**55.9%**	**14.8%**	**37.2%**
Weighted Average H1'2018	**2.9**	**10.0%**	**55.9%**	**14.4%**	**34.3%**

**Market cap weighted average as at 6th September 2019*

Listed Banks Trading Metrics

The listed banking sector has continued to trade at cheaper prices, as it is currently trading at an average P/TBv of 1.2x and average P/E of 6.0x

Bank	No. of shares (bn)	Market Cap (bn)	P/E	Price*	P/TBV
HF Group	0.4	1.7	2.7x	4.4	0.2x
NBK	0.3	1.4	3.2x	4.1	0.2x
NIC Bank	0.7	19.8	4.5x	28.1	0.6x
DTBK	0.3	31.7	4.3x	113.5	0.6x
I&M Holdings	0.8	38.4	4.5x	46.5	0.8x
Coop Bank	5.9	66.3	5.1x	11.3	1.0x
KCB Group	3.1	117.1	4.8x	38.2	1.0x
Stanbic Bank	0.4	37.9	5.6x	96.0	1.0x
Barclays Bank	5.4	59.5	7.9x	11.0	1.4x
Equity Group	3.8	140.0	6.7x	37.1	1.5x
SCBK	0.3	67.2	8.1x	195.5	1.5x
Weighted Average H1'2019			**6.0x**		**1.2x**

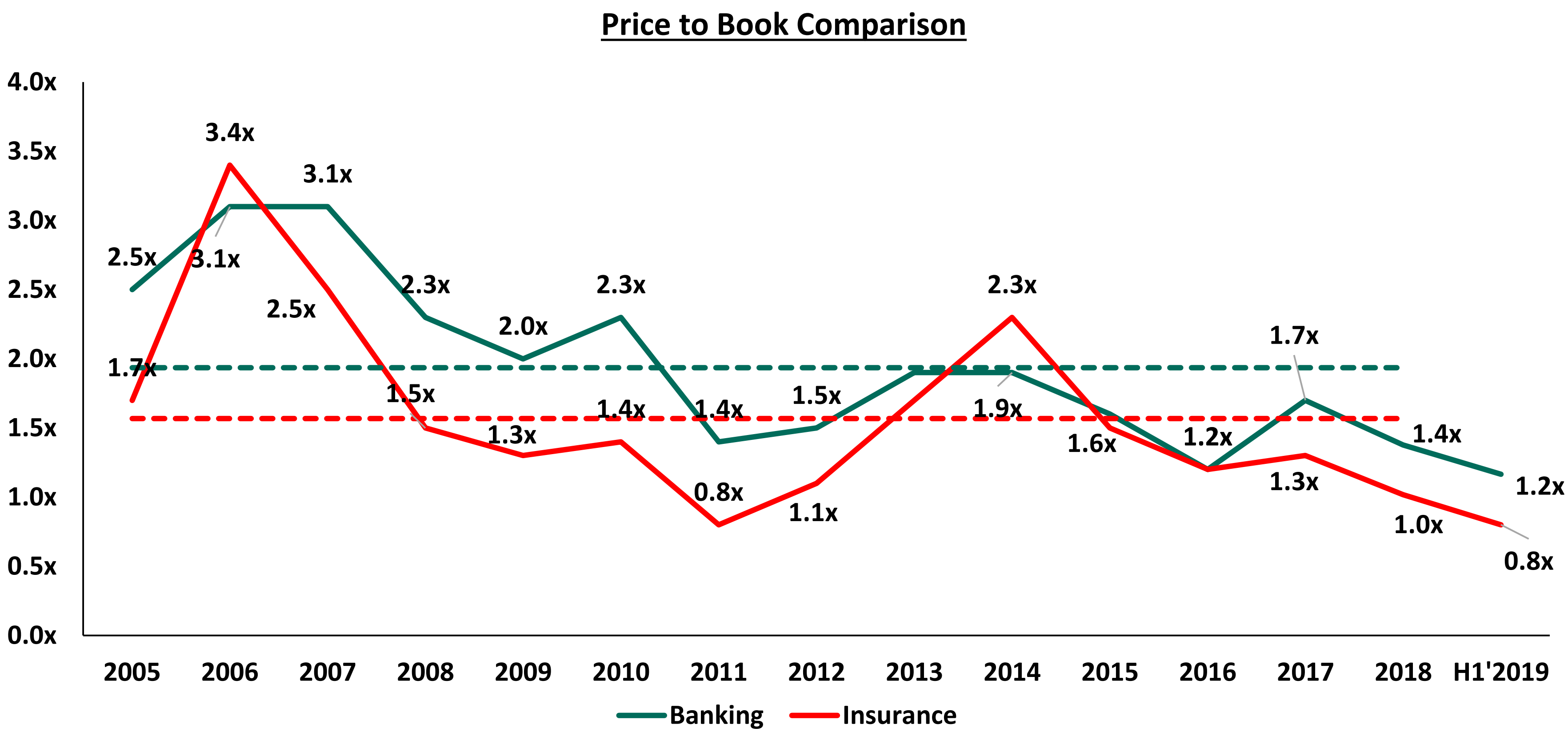
P/E calculation for HF used normalized earnings over a period of 5 years

**Prices as at 6th September 2019*

Listed Banks & Insurance Trading Metrics

Listed banks trade at an average P/B of 1.2x, higher than the insurance sector, which is priced at 0.8x. Both sectors are trading below their 14-year averages of 1.9x and 1.6x, respectively

14 year Price to Book Value: Banking and Insurance



On a price to book valuation, listed banks are currently priced at a PBV of 1.2x, higher than listed insurance companies at 0.8x, with both lower than their historical averages of 1.9x for the banking sector and 1.6x for the insurance sector

Summary of the H1’2019 Earnings

Listed banks continued to record a relatively strong performance, aided by Non-Funded Income expansion as well as improvements in operational efficiency

1. The sector continued to record a positive performance, recording a market cap-weighted increase of 9.0% in core earnings per share in H1’2019, with non-funded revenue expansion and cost rationalization strategies taking effect. Operational efficiency has continued to improve, as shown by the improvement in the cost to income without LLP ratio to 48.8%, from 49.7% in H1’2018
2. The level of NPLs remains a concern within the banking sector, with the weighted average gross Non-Performing Loans (NPL) ratio for the listed banks rising to 10.0%, from 9.8% in H1’2018, with the sectors touted as the main contributors being real estate, manufacturing and retail. If the asset deterioration trend persists, this will likely impact bank’s bottom line, due to the associated impairment charges, especially after the adoption of the new IFRS 9 standard
3. The sector continued to record a relatively strong balance sheet growth, as deposits grew by 8.6%, slower than loans which grew by 9.8%. Loan growth is faster than the 3.8% y/y growth recorded in H1’2018, on higher segmented lending by banks to corporates, and secured borrowers

IV. Banks Valuation Reports

Valuation Summary of Listed Banks

I&M Holdings presents the highest upside with an expected total return of 79.1%

Bank	Current Price	Target Price	Dividend Yield	Upside/ Downside	Total Return
I&M Holdings	46.5	79.8	7.5%	71.5%	**79.1%**
KCB Group	40.2	61.4	8.7%	52.6%	**61.5%**
Diamond Trust Bank	113.5	175.6	2.3%	54.7%	**57.0%**
Equity Group	37.1	53.0	5.4%	42.9%	**48.2%**
Co-operative Bank	11.3	15.0	8.8%	32.7%	**41.5%**
NIC Group	28.1	37.9	4.4%	34.9%	**39.3%**
Barclays Bank	11.0	12.6	10.0%	14.9%	**24.9%**
Standard Chartered Bank	195.0	208.0	9.7%	6.7%	**16.4%**
Stanbic Holdings	96.0	100.5	6.0%	4.7%	**10.7%**
HF Group	4.0	2.8	0.0%	(30.3%)	**(30.3%)**

A. Tier I Banks

I. Equity Group Holdings

Equity Group's Summary of Performance – H1'2019

- Equity Group recorded a profit before tax growth of 9.8% to Kshs 17.0 bn, up from Kshs 15.5 bn in H1'2018. Profit after tax grew by 8.9% to Kshs 12.0 bn in H1'2019, from Kshs 11.0 bn in H1'2018, with the difference in growth attributable to the marginal increase in the effective tax rate to 29.3% from 28.8% in H1'2018
- Total operating income recorded a 14.8% growth to Kshs 37.6 bn, from Kshs 32.8 bn in H1'2018. This was driven by a 25.6% growth in Non-Funded Income (NFI) to Kshs 16.5 bn, from Kshs 13.2 bn in H1'2018, coupled with a 7.6% growth in Net Interest Income to Kshs 21.1 bn, from Kshs 19.6 bn in H1'2018
- Total operating expenses rose by 19.4% to Kshs 20.6 bn, from Kshs 17.3 bn in H1'2018, largely driven by a 16.7% increase in Loan Loss Provisions (LLP) to Kshs 0.9 bn, from Kshs 0.8 bn in H1'2018, coupled with a 22.1% growth in other operating expenses to Kshs 13.8 bn, from Kshs 11.3 bn in H1'2018, and a 13.8% rise in staff costs to Kshs 5.9 bn, from Kshs 5.2 bn in H1'2018
- The balance sheet recorded an expansion as total assets grew by 17.8% to Kshs 638.6 bn, from Kshs 542.0 bn in H1'2018. Growth was supported by a 16.7% growth in loans and advances to Kshs 320.9 bn, from Kshs 275.0 bn in H1'2018, coupled with a 13.0% growth in government Securities to Kshs 179.6 bn, from Kshs 158.9 bn in H1'2018
- Asset quality deteriorated as Gross Non-Performing Loans (NPLs) increased by 19.6% to Kshs 29.2 bn in H1'2019, from Kshs 24.5 bn in H1'2018. The NPL ratio thus deteriorated to 8.8% in H1'2019 from 8.5% in H1'2018.
- Going forward, we expect the bank's growth to be driven by:
    a) **Increased channeled diversification**, which is likely to further improve on efficiency, with emphasis on alternative channels of transactions, as the bank rides on the digital revolution wave, thereby further improving the cost to income ratio by cost rationalization and revenue expansion.

Financial Statements Extracts

Equity Group's PAT is expected to grow at a 5-year CAGR of 13.8%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	37.6	41.4	43.8	49.8
Non Funded Income	27.6	25.9	29.8	33.8
Loan Loss Provision	(3.4)	(3.7)	(3.9)	(4.3)
Other Operating Expenses	(34.8)	(35.1)	(38.0)	(42.1)
Total Operating Expenses	**(38.3)**	**(38.8)**	**(41.9)**	**(46.3)**
Profit Before Tax	26.9	28.5	31.7	37.3
Profit After tax	18.9	19.8	22.2	26.1
% PAT Change YoY	**14.0%**	**4.8%**	**11.9%**	**17.7%**
EPS	5.0	5.3	5.9	6.9
DPS	2.0	2.0	2.2	2.5
Cost to Income	58.7%	57.7%	56.9%	55.4%
NIM	8.9%	8.5%	8.2%	8.2%
ROaE	21.6%	22.5%	22.3%	22.9%
ROaA	3.8%	3.8%	3.6%	3.7%

Balance Sheet	2017	2018	2019e	2020f
Net Loans and Advances	279.1	297.2	335.6	375.2
Government Securities	128.0	130.4	159.8	178.6
Other Assets	117.4	145.7	167.7	181.0
Total Assets	**524.5**	**573.4**	**663.2**	**734.8**
Customer Deposits	373.1	422.8	479.4	532.2
Other Liabilities	58.2	55.7	78.3	78.6
Total Liabilities	**431.3**	**478.4**	**557.7**	**610.8**
Shareholders Equity	93.1	94.1	104.5	123.0
Book value Per share	24.7	24.9	27.7	32.6
% Change in BPS YoY	**13.6%**	**1.0%**	**11.1%**	**17.8%**

Valuation Summary

Equity Group is undervalued with a potential upside of 48.2%

Cost of Equity Assumptions:	27-Sept-19
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.9
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.5%
Cost of Equity	21.4%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	22.3%
Return on Average Equity	21.8%
Terminal Price to Book value per share	1.8x
Shareholder Equity - FY23e	201.7
Terminal Value-(Year 2023)	371.7

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intergrated DDM	66.7	40.0%	26.7
Residual Income	54.7	35.0%	19.1
PBV Multiple	27.6	20.0%	5.5
PE Multiple	33.2	5.0%	1.7
Fair Value			**53.0**
Current Price			**37.1**
Upside/(Downside)			42.8%
Dividend Yield			5.4%
Total Return			**48.2%**

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

II. KCB Group

KCB Group Summary of Performance – H1’2019

- Profit before tax increased by 4.9% to Kshs 17.9 bn in H1’2019, up from Kshs 17.1 bn in H1’2018. Profit after tax grew by 5.0% to Kshs 12.7 bn in H1’2019, from Kshs 12.1 bn in H1’2018 with the effective tax rate increasing to 33.2% from 32.3% in H1’2018
- Total operating income increased by 8.3% to Kshs 38.6 bn from Kshs 35.6 bn in H1’2018. This was driven by a 14.7% increase in Non-Funded Income (NFI) to Kshs 13.2 bn, from Kshs 11.5 bn in H1’2018, coupled with a 5.2% increase in Net Interest Income (NII) to Kshs 25.4 bn from Kshs 24.1 bn in H1’2018
- Total operating expenses increased by 11.4% to Kshs 20.6 bn, from Kshs 18.5 bn, largely driven by a 266.2% rise in Loan Loss Provisions (LLP) to Kshs 3.0 bn in H1’2019, from Kshs 827.7 mn in H1’2018, coupled with a 4.6% rise in staff costs to Kshs 9.0 bn in H1’2019, from Kshs 8.6 bn in H1’2018. The balance sheet recorded an expansion as total assets increased by 12.1% to Kshs 725.7 bn, from Kshs 647.5 bn in H1’2018.
- The bank’s asset quality improved, with the NPL ratio improving to 7.8% from 8.4% in H1’2018. The improved NPL ratio was mainly attributed to an improvement in the corporate loan book’s NPL ratio to 9.5% in H1’2019 from in 11.6% in H1’2018, as well as the SME and Micro loan book, which improved to 14.1% in H1’2019, down from 15.2% in H1’2018, respectively
- Going forward, we expect the bank’s growth to be driven by:

i. **Increased channeled diversification**, which is likely to help the bank to continue improving its operational efficiency. The benefits of this are already being felt, as the bank aligned its staff head count to its operational needs. Continued emphasis on these alternative channels of transactions, as the bank rides on the digital revolution wave, will likely lead to further cost to income ratio improvements by cost rationalization and NFI expansion.

Financial Statements Extracts

KCB Group's PAT is expected to grow at a 5-year CAGR of 9.2%

Income Statement	2017	2018	2019e	2020F
Net Interest Income	48.4	48.8	51.4	56.5
Non Funded Income	23.0	23.0	26.9	28.7
Loan Loss Provision	5.9	2.9	4.7	5.1
Other Operating Expenses	36.4	35.0	36.5	38.9
Total Operating Expenses	**42.3**	**37.9**	**41.2**	**44.0**
Profit Before Tax	29.1	33.9	37.1	41.3
Profit After tax	19.7	24.0	25.9	28.9
% PAT Change YoY	**(0.1%)**	**21.8%**	**9.5%**	**11.3%**
EPS	6.3	7.7	8.6	9.5
DPS	3.0	3.5	4.0	4.6
Cost to Income	59.2%	52.8%	52.7%	51.6%
ROE	19.5%	21.9%	22.0%	21.8%
ROA	3.2%	3.6%	3.7%	4.0%

Balance Sheet	2017	2018	2019e	2020f
Net Loans and Advances	422.7	455.9	493.5	527.9
Government Securities	110.0	120.1	129.3	140.3
Total Assets	**646.7**	**714.3**	**770.5**	**833.4**
Customer Deposits	499.5	537.5	577.4	619.0
Total Liabilities	**540.7**	**600.7**	**649.2**	**692.7**
Shareholders Equity	**106.0**	**113.7**	**121.3**	**140.8**
Book value Per share	35.0	37.6	40.1	46.5
% Change in BPS YoY	**9.7%**	**7.3%**	**6.7%**	**16.1%**

Valuation Summary

KCB Group is undervalued with a total potential return of 61.5%

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

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.8%
Return on Average Equity 2023	18.5%
Terminal Price to Book value per share	1.2x
Shareholder Equity - FY23e	215.7
Terminal Value - (Year 2023)	280.5

Valuation Summary	Implied Price	Weighting	Weighted Value
Residual Income	57.9	35%	20.3
PBV Multiple	45.7	20%	9.1
PE Multiple	52.4	5%	2.6
DDM Integrated	73.3	40%	29.3
Target Price			**61.4**
Current Price			**40.2**
Upside/(Downside)			52.8%
Dividend Yield			8.7%
Total Return			**61.5%**

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

III. Co-operative Bank

Co-operative Bank's Summary of Performance – H1'2019

- Co-operative Bank recorded a profit before tax increase by 4.6% to Kshs 10.4 bn, up from Kshs 10.0 bn in H1'2018. Profit after tax grew by 4.6% to Kshs 7.5 bn in H1'2019, from Kshs 7.1 bn in H1'2018
- Total operating income increased by 5.5%
- Total operating expenses increased by 5.2% to Kshs 12.6 bn, from Kshs 12.0 bn in H1'2018, largely driven by the 8.1% rise in Loan Loss Provisions (LLP) to Kshs 1.2 bn from Kshs 1.1 bn in H1'2018, coupled with the 3.1% increase in other operating expenses to Kshs 5.7 bn, from Kshs 5.5 bn in H1'2018, and the 6.8% increase in staff costs to Kshs 5.7 bn, from Kshs 5.3 bn in H1'2018
- The balance sheet recorded an expansion as total assets increased by 7.8% to Kshs 429.6 bn, from Kshs 398.4 bn in H1'2018. Growth was supported by a 14.2% growth in government securities to Kshs 95.0 bn, from Kshs 83.1 bn, coupled with the 2.6% increase in the loan book to Kshs 257.6 bn from Kshs 251.1 bn in H1'2018
- The bank's asset quality deteriorated, with the NPL ratio deteriorating to 11.2%, from 10.9% in H1'2018. The main sectors that contributed to the NPLs were trade, personal consumer, manufacturing and real estate
- Going forward, we expect the bank's growth to be driven by:
    a) **Focus on diversification:** The bank's continued focus on channel diversification will likely continue to help the bank in generating profitability, as they continue to record increased usage and traffic. The focus on branch transformation and innovation centered on alternative channels will continue to drive NFI growth as well as transform braches to handle advisory, wealth management and advisory services
    b) **Enhanced Credit Management:** The bank continues to manage its loan portfolio through, cherry-picking of loan issuances, proactive debt management such as loan due reminders, enhancement of systems, processes and tooling to support credit management mainly loan origination process, and sustained collections

Financial Statements Extracts

Co-operative Bank's PAT is expected to grow at a 5-year CAGR of 7.0%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	28.1	30.8	30.2	32.4
Non Funded Income	13.5	12.9	16.6	17.7
Loan Loss Provision	3.6	1.8	2.1	2.3
Other Operating Expenses	21.7	23.9	24.6	25.4
Total Operating Expenses	25.3	25.7	26.7	27.7
Profit Before Tax	16.4	18.2	20.1	22.3
Profit After tax	11.4	12.7	14.1	15.6
% PAT Change YoY	**(10.0%)**	**11.6%**	**10.5%**	**11.1%**
EPS	2.3	2.6	2.9	3.2
DPS	1.0	1.2	1.2	1.2
Cost to Income	60.9%	58.8%	57.1%	55.4%
NIM	8.8%	9.5%	8.3%	8.3%
ROE	17.4%	18.3%	19.1%	19.0%
ROA	3.1%	3.3%	3.2%	3.3%

Balance Sheet	2017	2018	2019e	2020f
Net Loans and Advances	253.9	245.4	269.1	282.6
Government Securities	44.0	49.7	61.8	57.7
Other Assets	89.0	118.3	122.4	143.6
Total Assets	**386.9**	**413.4**	**453.2**	**483.8**
Customer Deposits	287.4	306.1	340.0	360.4
Other Liabilities	29.2	36.1	34.3	34.7
Total Liabilities	**316.6**	**342.2**	**374.2**	**395.1**
Shareholders Equity	69.6	69.9	77.6	87.4
Book value Per share	14.2	14.3	15.9	17.9
% Change in BPS YoY	**13.5%**	**13.9%**	**11.1%**	**12.6%**

Valuation Summary

Co-operative Bank is undervalued with a potential upside of 39.8%

Cost of Equity Assumptions:	27-Sep-19
Risk free rate *	13.2%
Beta	0.90
Country Risk Premium	7.6%
Extra Risk Premium	0.9%
Cost of Equity	20.9%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	21.7%
Return on Average Equity	16.1%
Terminal Price to Book value per share	1.1x
Shareholder Equity - FY23e	115.79
Terminal Value-(Year 2023)	133.73

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	18.5	40%	7.4
Residual income	13.1	35%	4.6
PBV Multiple	12.0	20%	2.4
PE Multiple	12.1	5%	0.6
Target Price			**15.0**
Current Price			**11.3**
Upside/(Downside)			32.7%
Dividend Yield			8.8%
Total Return			**41.5%**

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

IV. NIC Group

NIC Group Summary of Performance – H1'2019

- Profit before tax and exceptional items increased by 4.0% to Kshs 3.0 bn from Kshs 2.8 bn in H1'2018. Profit after tax declined by 4.2% to Kshs 1.9 bn in H1'2019 from Kshs 2.0 bn in H1'2018,
- Total operating income increased by 12.5% to Kshs 8.2 bn in H1'2019 from Kshs 7.3 bn in H1'2018. This was driven by a 7.7% increase in Net Interest Income (NII) to Kshs 5.5 bn from Kshs 5.1 bn in H1'2018, coupled with a 23.9% increase in Non-Funded Income (NFI) to Kshs 2.7 bn from Kshs 2.1 bn in H1'2018,
- Total operating expenses increased by 18.0% to Kshs 5.2 bn from Kshs 4.4 bn, largely driven by a 29.6% increase in loan loss provision (LLP) to Kshs 1.4 bn in H1'2019 from Kshs 1.1 bn in H1'2018. Staff costs also increased by 9.1% to Kshs 1.9 bn in H1'2019 from Kshs 1.7 bn in H1'2018,
- The balance sheet recorded an expansion with total assets growth of 6.6% to Kshs 214.1 bn from Kshs 201.0 bn in H1'2018. This growth was largely driven by an 8.1% increase in government securities to Kshs. 60.3 bn from Kshs. 55.7 bn in H1'2018,
- Going forward, we expect the bank's growth to be driven by:
    a) The merger with CBA will likely enable NIC mobilize cheaper funding, leveraging on the scale and market reach of the combined entity as well as the digital channels. We expect this to help increase NIC's interest margins, thereby helping grow the interest income segment. Furthermore, alternative channel synergy would aid in NFI expansion, which should aid in generating higher profitability

NIC/CBA Merged Financial Statements

NIC Group's PAT is expected to grow at a 5-year CAGR of 10.5%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	20.4	20.3	23.4	25.8
Non Funded Income	14.6	16.1	16.0	19.3
Loan Loss Provision	6.0	6.1	4.9	6.8
Total Operating Expenses	22.7	24.1	24.8	29.0
Profit Before Tax	12.4	12.3	14.1	16.0
Profit After tax	8.2	8.9	9.6	11.2
% PAT Change YoY	**564.6%**	**9.3%**	**7.3%**	**17.0%**
EPS	12.8	14.0	15.0	17.5
DPS	1.0	0.0	2.2	2.6
Cost to Income	64.7%	66.3%	62.9%	64.4%
NIM	5.6%	5.2%	5.7%	5.7%
ROE	13.6%	13.7%	13.8%	14.4%
ROA	1.9%	2.0%	2.0%	2.2%

Balance Sheet	2017	2018e	2019e	2020f
Net Loans and Advances	233.4	239.6	260.7	281.6
Government Securities	120.2	129.7	144.5	156.9
Other Assets	98.3	84.3	93.5	105.9
Total Assets	**452.0**	**453.6**	**498.7**	**544.3**
Customer Deposits	332.7	341.0	372.5	402.2
Other Liabilities	54.4	46.2	52.9	59.2
Total Liabilities	**387.1**	**387.2**	**425.4**	**461.4**
Shareholders Equity	64.4	66.0	73.1	82.6
Book value Per share	7.19	7.37	8.16	9.22
% Change in BVPS	**14.8%**	**2.5%**	**10.7%**	**13.1%**

Valuation Summary

NIC Group is undervalued with a total potential return of 39.3%

Cost of Equity Assumptions:	27-sep-19
Default Spread Adjusted Risk free rate	13.20%
Beta	1.00
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.0%
Cost of Equity	21.8%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	21.8%
Return on Average Equity	13.3%
Terminal Price to Book	0.7x
Shareholder Equity - FY23e	117.3
Terminal Value-(Year 2023)	85.6

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	42.9	40%	17.2
Residual Valuation	26.3	35%	9.2
PBV Multiple	48.6	20%	9.7
PE Multiple	36.5	5%	1.8
Target Price			**37.9**
Current Price			**28.1**
Upside/(Downside)			34.9%
Dividend Yield			4.4%
Total Return			**39.3%**

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

V. Standard Chartered Bank Kenya

SCBK's Summary of Performance – H1'2019

- Profit before tax increased by 5.3% to Kshs 6.9 bn, from Kshs 6.6 bn in H1'2018. Profit after tax grew by 5.4% to Kshs 4.7 bn in H1'2019, from Kshs 4.5 bn in H1'2018
- Total operating income declined by 0.7% to Kshs 14.6 bn from Kshs 14.7 bn in H1'2018. The decline was due to a 2.2% decline in Non-Funded Income(NFI) to Kshs 4.7 bn from Kshs 4.8 bn in H1'2018, Net Interest Income (NII) however remained flat at Kshs 9.8 bn
- Total operating expenses declined by 5.6% to Kshs 7.6 bn, from Kshs 8.1 bn in H1'2018, largely driven by a 70.1% decline in loan loss provisions to Kshs 378.9 mn, from Kshs 1.3 bn in H1'2018. The large decline in loan loss provisions was however mitigated by a 6.1% rise in staff costs to Kshs 3.5 bn, from Kshs 3.3 bn in H1'2018
- The balance sheet recorded a contraction as total assets declined by 0.5% to Kshs 294.5 bn, from Kshs 296.0 bn in H1'2018.
- The bank's asset quality improved, with the NPL ratio decreasing to 14.6% from 14.8% in H1'2018. The improving NPL ratio is attributable to the faster growth in gross loans that outpaced the growth in the gross Non-performing Loans (NPLs)
- Going forward, we expect the bank's growth to be driven by:
    a) Continued focus on promoting the usage of the bank's alternative channels is likely to boost the company's Non-Funded Income (NFI) as well as aiding in improving operational efficiency levels, which deteriorated in H1'2019 as evidenced by the worsening of the cost to income ratio to 49.9%, from 46.6% in H1'2018. Revenue expansion coupled with cost containment will be key in boosting the bank's bottom line..

Financial Statements Extracts

SCBK's PAT is expected to grow at a 5-year CAGR of 9.0%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	18.6	19.4	19.2	20.8
Non Funded Income	8.8	9.2	9.7	10.4
Loan Loss Provision	4.2	1.9	1.9	2.0
Total Operating Expenses	**17.3**	**16.8**	**16.6**	**17.5**
Profit Before Tax	10.1	11.8	12.3	13.8
Profit After tax	6.9	8.1	8.4	9.4
% PAT Change YoY	**(23.6%)**	**17.1%**	**3.1%**	**12.4%**
EPS	20.1	23.6	24.3	27.3
DPS	17.0	19.0	19.4	21.9
Cost to Income	63.2%	58.6%	57.5%	55.8%
NIM	7.9%	7.5%	7.5%	7.8%
ROaE	15.4%	17.5%	18.5%	21.0%
ROaA	2.6%	2.8%	2.9%	3.1%

Balance Sheet	2017	2018e	2019e	2020f
Net Loans and Advances	126.3	118.7	123.3	133.9
Government Securities	110.5	98.7	110.4	118.7
Other assets	48.9	68.0	61.5	62.2
Total Assets	**285.7**	**285.4**	**295.3**	**314.8**
Customer Deposits	213.3	224.3	234.9	252.6
Other Liabilities	26.7	14.5	16.5	16.5
Total Liabilities	**240.1**	**238.8**	**251.4**	**269.1**
Shareholders Equity	45.7	46.6	43.8	45.7
Book value Per share	132.9	135.8	127.6	133.1
% Change in BPS YoY	**4.0%**	**2.1%**	**(6.0%)**	**4.3%**

Valuation Summary

SCBK is undervalued with a total potential total return of 13.8%

Cost of Equity Assumptions:	27-Sep-19
Default Spread Adjusted Risk free rate	13.2%
Beta	0.8
Mature Market Risk Premium	7.6%
Extra Risk Premium	0.0%
Cost of Equity	19.3%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	20.8%
Return on Average Equity 2023	24.9%
Terminal Price to Book value per share	1.8x
Shareholder Equity - FY23e	52.6
Terminal Value-(Year 2023)	99.3

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	231.7	40%	92.7
Residual Income	225.8	35%	79.0
PBV Multiple	144.9	20%	29.0
PE Multiple	145.8	5%	7.3
Target Price			**208.0**
Current Price			**195.0**
Upside/(Downside)			6.7
Dividend Yield			9.7%
Total Return			**16.4%**

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

VI. Diamond Trust Bank Kenya

DTBK's Summary of Performance – H1'2019

- DTBK recorded a profit before tax increase of 10.2% to Kshs 6.0 bn, up from Kshs 5.4 bn in H1'2018. Profit after tax grew by 10.4% to Kshs 4.1 bn in H1'2019, from Kshs 3.8 bn in H1'2018
- Total operating income declined by 4.0% to Kshs 12.2 bn, from Kshs 12.7 bn in H1'2018, occasioned by the 7.5% decline in Net Interest Income (NII) to Kshs 9.2 bn, from Kshs 9.9 bn in H1'2018, which offset the 8.5% increase in Non-Funded Income (NFI) to Kshs 3.0 bn, from Kshs 2.7 bn in H1'2018
- Total operating expenses declined by 14.4% to Kshs 6.2 bn, from Kshs 7.3 bn, largely driven by the 68.1% decline in Loan Loss Provisions (LLP) to Kshs 0.5 bn in H1'2019, from Kshs 1.7 bn in H1'2018, which offset the 6.2% rise in staff costs to Kshs 2.2 bn in H1'2019, from Kshs 2.1 bn in H1'2018
- The balance sheet recorded a marginal decrease with total assets decreased by 0.05% to Kshs 375.9bn, from Kshs 376.1 bn in H1'2018. This decrease was largely driven by a 6.5% decrease in government securities to Kshs 120.7 bn in H1'2019, from Kshs 129.2 bn in H1'2018, coupled with a 59.4% increase in other assets to Kshs 13.4 bn, from Kshs 8.4 bn in H1'2018, which outweighed the 3.8% decline in the loan book to Ksh 190.8bn, from Kshs 198.2 bn in H1'2018
- The bank experienced an improvement in its asset quality as the gross Non-Performing Loans (NPLs) declined by 1.0% to Kshs 15.1 bn in H1'2019 from Kshs 15.3 bn in H1'2018, and consequently, the NPL ratio deteriorated to 7.6%, from 7.3% in H1'2018

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

Regional diversification: We continue to expect DTBK's increased regional presence to aid in enhancing growth. We expect DTBK's increased focus on other regions to boost the growth in the bottom line, largely supported by the expansion of funded income which has remained subdued largely due to the pricing restriction existent in Kenya.

Financial Statements Extracts

DTBK's PAT is expected to grow at a 5-year CAGR of 8.6%

Income Statement	2017	2018	2019f	2020f
Net Interest Income	19.7	20.0	20.4	21.6
Non Funded Income	5.3	5.4	5.7	6.0
Loan Loss Provision	4.3	3.0	2.2	2.2
Other Operating Expenses	6.6	7.3	7.3	7.7
Total Operating Expenses	**14.9**	**14.5**	**14.0**	**14.7**
Profit Before Tax	10.1	11.0	12.2	13.0
Profit After tax	6.9	7.1	8.3	8.8
% PAT Change YoY	**(10.3%)**	**2.3%**	**17.0%**	**6.4%**
EPS	24.8	23.9	28.8	30.6
DPS	2.6	2.6	3.3	6.3
Cost to Income	59.6%	56.9%	53.4%	53.2%
NIM	**6.5%**	**6.2%**	**6.1%**	**6.1%**
ROE	14.4%	13.9%	13.4%	12.3%
ROA	2.0%	1.9%	2.0%	2.0%
Balance Sheet	**2017**		**2019f**	**2020f**
Net Loans and Advances	196.0	193.1	197.9	210.7
Government Securities	112.5	115.0	115.7	123.2
Other Assets	54.7	69.6	100.9	108.2
Total Assets	**363.3**	**377.7**	**414.4**	**442.1**
Customer Deposits	266.2	282.9	304.4	324.2
Other Liabilities	43.4	35.9	38.4	39.5
Total Liabilities	**309.7**	**318.8**	**342.8**	**363.7**
Shareholders Equity	48.4	53.7	66.1	72.9
Book value Per share	173.0	191.9	236.2	260.6
% Change in BPS YoY	**17.9%**	**10.9%**	**23.1%**	**10.3%**

Valuation Summary

DTBK is undervalued with a potential upside of 56.5%

Cost of Equity Assumptions:	27/09/2019
Default Spread Adjusted Risk free rate	13.2%
Beta	0.8
Mature Market Risk Premium	7.6%
Extra Risk Premium	0.0%
Cost of Equity	19.3%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.8%
Return on Average Equity 2023	11.7%
Terminal P/B	0.8x
Shareholder Equity - FY23e	92.1
Terminal Value-(Year 2023)	76.5

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	189.1	40.0%	75.6
Residual Income	113.3	35.0%	39.6
PBV Multiple	255.1	20.0%	51.0
PE Multiple	173.7	5.0%	8.7
Target Price			**175.0**
Current Price			**113.5**
Upside/(Downside)			54.2%
Dividend yield			2.3%
Total return			**56.5%**

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

VII. Barclays Bank of Kenya

Barclays Bank’s Summary of Performance – H1’2019

- Profit before tax increased by 8.1% to Kshs 5.7 bn, up from Kshs 5.3 bn in H1’2018. Profit after tax grew by 3.1% to Kshs 3.9 bn in H1’2019, from Kshs 3.8 bn in H1’2018 as the effective tax rate increased to 32.1% from 28.8% in H1’2018,
- Total operating income rose by 4.2% to Kshs 16.3 bn, from Kshs 15.7 bn in H1’2018, driven by the 12.6% growth in Non-Funded Income (NFI) to Kshs 5.3 bn, from Kshs 4.7 bn in H1’2018, coupled with the marginal 0.6% increase in Net Interest Income (NII) to Kshs 11.0 bn, from Kshs 10.97 bn in H1’2018,
- Total operating expenses declined by 3.2% to Kshs 10.1 bn, from Kshs 10.4 bn, largely driven by the 6.3% decline in staff costs to Kshs 4.8 bn in H1’2019, from Kshs 5.1 bn in H1’2018, coupled with the 4.4% decline in Loan Loss Provisions (LLP) to Kshs 1.6 bn, from Kshs 1.7 bn in H1’2018, which outweighed the 1.8% rise in other operating expenses to Kshs 3.62 bn, from Kshs 3.56 bn in H1’2018,
- The balance sheet recorded an expansion as total assets increased by 11.8% to Kshs 353.8 bn, from Kshs 316.6 bn in H1’2018. This growth was largely driven by a 15.4% increase in investments in securities to Kshs 81.2 bn, from Kshs 70.3 bn in H1’2018, coupled with a 27.6% increase in other assets to Kshs 53.6 bn, from Kshs 42.0 bn in H1’2018,
- Asset quality continued to experience a deterioration, as highlighted by the rise in the NPL ratio to 7.9% from 7.7% in H1’2018. Main sectors that continue to experience challenges include trade, manufacturing and retail,
- Going forward, we expect the bank’s growth to be driven by:
  - **a)** Increased Channel diversification, which is likely to help the bank to continue improving its operational efficiency. The benefits of this are already being felt with “Timiza” already recording an accelerated growth, and consequently higher Non-Interest Revenue. This, coupled with the expansion of its agent banking network and product offerings such as banc assurance and fixed income trading will see the bank expand its topline revenue, going forward.

Financial Statements Extracts

Barclays Bank's PAT is expected to grow at a 5-year CAGR of 11.0%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	21.8	22.0	23.5	24.6
Non Funded Income	8.5	9.7	10.7	11.9
Loan Loss Provision	(3.1)	(3.9)	(4.0)	(4.4)
Total Operating Expenses	(19.9)	(21.0)	(22.1)	(23.6)
Profit Before Tax	10.4	10.6	11.5	12.9
Profit After tax	6.9	7.4	8.1	9.0
% PAT Change YoY	**(6.4%)**	**7.1%**	**8.9%**	**11.5%**
EPS	1.3	1.4	1.5	1.7
DPS	1.0	1.1	1.3	1.3
Cost to Income	65.8%	66.4%	64.6%	64.7%
NIM	9.7%	8.6%	8.4%	8.7%
ROE	16.0%	16.8%	18.0%	19.3%
ROA	2.7%	2.7%	2.6%	2.8%

Balance Sheet	2017	2018	2019e	2020f
Net Loans and Advances	168.4	177.4	189.7	206.2
Government Securities	58.5	92.9	80.8	84.7
Other Assets	44.3	54.5	89.3	89.9
Total Assets	**271.2**	**324.8**	**359.8**	**380.8**
Customer Deposits	186.0	207.4	234.2	253.0
Other Liabilities	41.1	73.2	79.8	80.2
Total Liabilities	**227.1**	**280.6**	**314.0**	**333.2**
Shareholders Equity	44.1	44.2	45.4	47.2
Book value Per share	8.1	8.1	8.4	8.7
% Change in BPS YoY	**4.0%**	**0.2%**	**2.6%**	**4.0%**

Valuation Summary

Barclays Bank is undervalued with a potential upside of 24.9%

Cost of Equity Assumptions:	27-Sep-19
Default Spread Adjusted Risk free rate	13.2%
Beta	0.90
Mature Market Risk Premium	7.6%
Extra Risk Premium	0.0%
Cost of Equity	19.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.8%
Return on Average Equity 2022	25.1%
Terminal Price to Book value per share	1.6x
Shareholder Equity - FY23e	54.0
Terminal Value-(Year 2021)	93.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	13.2	40%	5.3
Residual Income	14.9	35%	5.2
PBV Multiple	8.5	20%	1.7
PE Multiple	8.0	5%	0.4
Target Price			**12.6**
Current Price			**11.0**
Upside/(Downside)			14.8%
Dividend Yield			10.0%
Total Return			**24.9%**

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

VIII. Stanbic Holdings

Stanbic Bank Summary of Performance – H1’2019

- Stanbic Bank recorded a profit before tax growth of 7.1% to Kshs 5.6 bn, up from Kshs 5.2 bn in H1’2018. Profit after tax recorded a growth of 14.4% to Kshs 4.1 bn in H1’2019, from Kshs 3.6 bn in H1’2018
- Total operating income increased by 14.8% to Kshs 12.8 bn in H1’2019, from Kshs 11.2 bn in H1’2018. This was driven by a 19.5% increase in Net Interest Income (NII) to Kshs 6.7 bn, from Kshs 5.6 bn in H1’2018, coupled with a 10.1% increase in Non-Funded Income (NFI) to Kshs 6.1 bn, from Kshs 5.6 bn in H1’2018
- Total operating expenses rose by 21.6% to Kshs 7.3 bn, from Kshs 6.0 bn in H1’2018, largely driven by an 387.6% increase in the Loan Loss Provision (LLP) to Kshs 1.2 bn, from Kshs 0.3 bn in H1’2018, and a 3.2% increase in staff costs to Kshs 2.9 bn, from Kshs 2.8 bn, in H1’2018
- The balance sheet recorded an expansion as total assets increased by 12.4% to Kshs 313.3 bn, from Kshs 278.8 bn in H1’2018. This growth was largely driven by a 15.0% increase in net loans s and advances to Kshs 177.1 bn
- The bank experienced a deterioration in asset quality, as Gross non-performing loans increased by 69.7% to Kshs 17.9 bn from Kshs 10.6 bn in H1’2018. Consequently, the NPL ratio deteriorated to 9.6% from 6.6% in H1’2018
- Going forward, we expect the bank’s growth to be driven by:
    a) **Efficient operating model-**The bank’s increased focus on cost containment is likely to boost the bank’s growth prospects, as it looks to drive its strategy of increased deposit mobilization capacity and lending. This will likely ring in additional interest income, thereby improving the top line revenue. Furthermore, the banks well diversified revenue structure will likely buffer the bottom in the event of a significant decline in one of the revenue streams

Financial Statements Extracts

Stanbic Holdings PAT is expected to grow at a 5-year CAGR of 8.1%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	10.6	12.1	13.6	13.7
Non Funded Income	8.4	10.0	11.5	12.8
Loan Loss Provision	(2.8)	(2.1)	(2.7)	(2.8)
Total Operating Expenses	**(13.7)**	**(13.1)**	**(15.3)**	**(16.4)**
Profit Before Tax	5.4	9.0	9.8	10.2
Profit After tax	4.3	6.3	6.8	7.1
% PAT Change YoY	**(2.5%)**	**45.8%**	**8.8%**	**4.3%**
EPS	10.9	15.9	17.3	18.0
DPS	-		4.3	4.5
Cost to Income	71.7%	59.5%	61.1%	61.7%
NIM	**5.1%**	**5.0%**	**5.1%**	**4.7%**
ROaE	10.4%	14.3%	14.8%	14.1%
ROaA	1.9%	2.3%	2.2%	2.1%

Balance Sheet	2017	2018e	2019e	2020f
Net Loans and Advances	143.3	175.0	179.7	197.7
Other Assets	105.5	115.6	137.1	153.3
Total Assets	**248.7**	**290.6**	**316.8**	**350.9**
Customer Deposits	193.4	219.5	240.4	271.9
Borrowings	4.0	7.1	9.2	9.2
Other Liabilities	8.4	19.4	19.3	19.3
Total Liabilities	**205.8**	**245.9**	**268.9**	**297.7**
Shareholders Equity	43.0	44.6	47.9	53.2
Book value Per share	108.7	112.9	121.1	134.7
% Change in BVPS	**7.0%**	**3.9%**	**7.3%**	**11.2%**

Valuation Summary

Stanbic Holdings is undervalued with a potential upside of 10.7%

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

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	21.8%
Return on Average Equity 2023f	13.5%
Terminal Price to Book value per share	0.8x
Shareholder Equity - FY23e	72.5
Terminal Value-(Year 2023)	63.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	110.8	40%	44.3
Residual income	96.2	35%	33.7
PBV Multiple	90.9	20%	18.2
PE Multiple	86.3	5%	4.3
Target Price			**100.5**
Current Price			**96.0**
Upside/(Downside)			4.7%
Dividend Yield			6.0%
Total Return			**10.7%**

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

B. Tier II Banks

Cytonn

I. I&M Holdings

I&M Holdings Summary of Performance – H1’2019

- 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% to Kshs 4.5 bn in H1’2019 from Kshs 3.9 bn recorded in a similar period in 2018
- 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
- 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 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.
- 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, we expect the bank’s growth to be driven by:
    a) **NFI Growth Initiatives** – I&M Holdings’ NFI growth is improving as the bank focuses on digital innovation to augment transaction volumes and increase fee income. The bank needs to increase capacity of its brokerage and advisory businesses so as to increase income contribution from investment and advisory services

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

Financial Statement Extracts

I&M Holdings PAT is expected to grow at a 5-year CAGR of 11.1%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	15.6	15.6	16.0	19.1
Non- Funded Income	5.8	7.6	9.9	11.2
Loan Loss Provision	4.1	3.8	3.6	5.0
Staff costs	3.7	4.0	4.7	5.1
Total Operating Expenses	**11.9**	**12.2**	**13.7**	**16.4**
Profit Before Tax	9.9	11.5	12.6	14.3
Profit After Tax	7.3	8.5	8.8	10.0
% PAT Change YoY	**(6.4%)**	**17.1%**	**3.5%**	**13.7%**
EPS	17.6	20.6	10.7	12.1
DPS	3.5	3.9	2.0	2.3
Cost to Income	56.2%	53.0%	53.0%	54.2%
NIM	8.8%	6.7%	5.6%	6.2%
ROaE	16.6%	17.2%	16.0%	16.9%
ROaA	3.0%	3.0%	2.6%	2.7%
Balance Sheet	**2017**	**2018**	**2019e**	**2020f**
Government securities	51.7	52.2	60.3	79.0
Net Loans and Advances	153.0	166.7	195.0	218.4
Total Assets	**240.1**	**288.5**	**344.2**	**384.6**
Customer Deposits	169.3	213.1	256.6	287.4
Total Liabilities	**193.1**	**237.6**	**286.2**	**318.5**
Shareholders Equity	44.3	47.9	55.0	63.1
Book Value Per Share	107.2	115.8	66.5	76.3
% BVPS Change YoY	**14.0%**	**8.0%**	**(40.0%)**	**15.0%**

Valuation Summary

I&M Holdings is undervalued with a total potential return of 79.1%

Cost of Equity Assumptions:	
Default Spread Adjusted Risk free rate	13.2%
Beta	0.5
Mature Market Risk Premium	7.6%
Extra Risk Premium	0.5%
Cost of Equity	17.5%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	21.34%
Return on Average Equity 2023	**16.3%**
Terminal Price to Book value per share	**1.2x**
Shareholder Equity - FY23e	94.3
Terminal Value-(Year 2023)	113.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	86.84	40%	34.74
Residual income	90.35	35%	31.62
PBV Multiple	53.14	20%	10.63
PE Multiple	55.32	5%	2.77
Target Price			**79.8**
Current Price			**46.5**
Upside/(Downside)			71.5%
Dividend yield			7.5%
Total Return			**79.1%**

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

II. HF Group

HF Group Summary of Performance – H1’2019

- HF Group recorded a loss before tax of Kshs 94.3 mn from a profit before tax of Kshs 12.6 mn in H1’2018. HF Group also recorded a loss after tax of Kshs 158.3 mn from a profit after tax of Kshs 37.1 mn in H1’2018
- Total operating income increased marginally by 0.6% to Kshs 1.94 bn, from Kshs 1.93 bn in H1’2018. This was driven by a 23.5% decline in Net Interest Income (NII) to Kshs 1.0 bn, from Kshs 1.3 bn in H1’2018, which was offset by a 55.8% increase in Non-Funded Income (NFI) to Kshs 914.2 mn from Kshs 586.8 mn in H1’2018
- Total operating expenses increased by 6.2% to Kshs 2.0 bn from Kshs 1.9 bn in H1’2018, largely driven by a 17.1% decline in staff costs to Kshs 498.5 mn from Kshs 601.4 mn in H1’2018 that offset the 61.9% rise in Loan Loss Provisions (LLP) to Kshs 369.5 mn from Kshs 228.1 mn, in H1’2018
- The balance sheet recorded a contraction as total assets declined by 13.0% to Kshs 57.0 bn, from Kshs 65.5bn in H1’2018. The contraction was mainly driven by a 14.8% decline in the loan book to Kshs 40.5 bn from Kshs 47.8 bn in H1’2018
- The bank experienced a deterioration in asset quality, with gross non-performing loans (NPLs) rising by 14.3% to Kshs 10.1 bn in H1’2019, from Kshs 8.9 bn in H1’2018. This warranted increased provisioning by 29.8% % to Kshs 2.5 bn, from Kshs 2.0 bn in H1’2018. The deteriorating asset quality, coupled with the tough operating environment occasioned by the interest rate cap, has continued to hamper the bank’s lending activities, leading to a decline in its interest income

HF Group Summary of Performance – H1'2019

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

1. NFI growth expansion: The growth in NFI could be driven by increased adoption of alternative channels. The bank is currently focusing on deepening its digital banking proposition having launched their digital banking platform in July, dubbed HF Whizz, which will enable customers to open an account, access loans, and deposit and transfer cash on mobile phones in a bid to grow non – funded income streams. This will improve operational efficiency as well as increase the bank's transactional income
2. Continued investment in digital channels to enhance accessibility as well as reduce operating expenses mainly through aligning staff costs to the bank's operational needs: On this end, the Bank undertook a redundancy exercise in 2018 in a cost-cutting drive, which saw the merging of some staff positions. This is expected to improve efficiencies in subsequent periods by providing clarity on operational accountabilities and curb the high operational costs
3. Fundamentally, we maintain our view that HF Group as a conventional bank has a long way to go, given its inability to mobilize deposits. In addition, mortgage penetration in Kenya remains low, and with the capping of interest rates, its ability to issue long term mortgage loans and effectively price for risk has been greatly hampered. The bank will ultimately have to adjust its business model, it seems that the end game will be coupling up with a strong bank with a sizeable asset base, and a strong deposit gathering capability, thereby complementing HF's strength in mortgages and real estate development.

Financial Statements Extracts

HF Group’s PAT is expected to decline at a 5-year CAGR of 200.8%

Income Statement	2017	2018	2019e	2020F
Net Interest Income	19.7	20.0	20.4	21.6
Non Funded Income	5.3	5.4	5.8	6.2
Loan Loss Provision	4.3	3.0	2.2	2.2
Other Operating Expenses	6.6	7.3	7.3	7.8
Total Operating Expenses	**14.9**	**14.5**	**14.0**	**14.7**
Profit Before Tax	10.1	11.0	12.2	13.0
Profit After tax	6.9	7.1	8.3	8.9
% PAT Change YoY	**(10.3%)**	**2.3%**	**17.6%**	**6.5%**
EPS	24.8	23.9	28.9	30.8
DPS	2.6	2.6	3.3	6.3
Cost to Income	59.6%	56.9%	53.3%	53.1%
NIM	**6.5%**	**6.2%**	**6.1%**	**6.1%**
ROE	14.4%	13.9%	13.5%	12.4%
ROA	2.0%	1.9%	2.0%	2.0%

Balance Sheet	2017	2018	2019e	2020f
Net Loans and Advances	49.6	43.4	39.9	39.9
Government Securities	2.3	3.2	3.3	3.1
Other Assets	15.6	13.9	12.9	12.7
Total Assets	**67.5**	**60.5**	**56.1**	**55.7**
Customer Deposits	36.7	34.7	32.9	32.7
Other Liabilities	19.4	15.5	12.8	12.8
Total Liabilities	**56.1**	**50.2**	**45.7**	**45.5**
Shareholders Equity	**11.4**	**10.4**	**10.1**	**9.9**
Book value Per share	32.5	29.4	28.7	28.2
% Change in BPS YoY	**1.4%**	**(3.2%)**	**(2.4%)**	**(3.3%)**

Valuation Summary

HF Group is overvalued with a total potential downside of 30.3%

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

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

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	5.5	40%	2.2
Residual Income	(1.8)	35%	(0.6)
PTBV Multiple	5.0	20%	1.0
PE Multiple	4.0	5%	0.2
Fair Value			**2.8**
Current Price			**4.0**
Upside/(Downside)			(30.3%)
Dividend Yield			0.0%
Total Return			**(30.3%)**

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

Appendix

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Feedback Summary

During the preparation of this H1'2019 Banking Sector Report, we shared with the subject companies the operating metrics that were used in the Report for their confirmation and verification

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

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

Thank You!

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