

Below is a summary of I&M Group Q3'2022 performance:

Balance Sheet Items (Kshs bn)	Q3'2021	Q3'2022	y/y change
Government Securities	117.5	114.4	(2.6%)
Net Loans and Advances	207.6	231.2	11.4%
Total Assets	399.1	428.7	7.4%
Customer Deposits	288.7	308.0	6.7%
Deposits per Branch	3.2	3.7	14.4%
Total Liabilities	326.9	355.2	8.7%
Shareholders' Funds	68.0	68.4	0.6%

Balance Sheet Ratios	Q3'2021	Q3'2022	y/y change
Loan to Deposit Ratio	71.9%	75.1%	3.2%
Return on average equity	14.3%	13.9%	(0.4%)
Return on average assets	2.5%	2.3%	(0.2%)

Income Statement (Kshs bn)	Q3'2021	Q3'2022	y/y change
Net Interest Income	14.0	16.2	15.6%
Non-Interest Income	6.2	8.8	43.0%
Total Operating income	20.2	25.0	24.0%
Loan Loss provision	(2.8)	(3.6)	27.5%
Total Operating expenses	(12.5)	(14.9)	19.1%
Profit before tax	8.1	10.4	28.9%
Profit after tax	5.7	7.2	25.1%
Earnings per share (Kshs)	3.5	4.3	25.1%

Income Statement Ratios	Q3'2021	Q3'2022	Y/Y Change
Yield from interest-earning assets	9.8%	10.5%	0.7%
Cost of funding	4.0%	4.2%	0.2%
Net Interest Spread	5.8%	6.3%	0.5%
Net Interest Income as % of Total Income	69.3%	64.6%	(4.7%)
Non-Funded Income as a % of Total Income	30.7%	35.4%	4.7%
Cost to Income	62.1%	59.7%	(2.4%)
Cost to Income Ratio without provisions	48.1%	45.3%	(2.8%)
Cost to Assets	2.4%	2.6%	0.2%
Net Interest Margin	6.0%	6.6%	0.6%

Capital Adequacy Ratios	Q3'2021	Q3'2022	% points change
Core Capital/Total deposit Liabilities	20.3%	20.7%	0.4%
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess	12.3%	12.7%	0.4%
Core Capital/Total Risk Weighted Assets	15.9%	15.3%	(0.7%)
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess	5.4%	4.8%	(0.7%)
Total Capital/Total Risk Weighted Assets	20.7%	20.1%	(0.6%)
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess	6.2%	5.6%	(0.6%)
Liquidity Ratio	49.4%	46.6%	2.8%
Minimum Statutory ratio	20.0%	20.0%	0.0%

Excess	29.4%	26.6%	(2.8%)
Adjusted Core Capital/Total Deposit Liabilities	20.4%	20.7%	0.3%
Adjusted Core Capital/Total Risk Weighted Assets	16.0%	15.3%	(0.7%)
Adjusted Total Capital/Total Risk Weighted Assets	20.7%	20.1%	(0.6%)

Income Statement

- Core earnings per share increased by 25.1% to Kshs 4.3 in Q3’2022, from Kshs 3.5 in Q3’2021, higher than our projections of a 18.7% increase to Kshs 4.1. The performance was driven by a 24.0% increase in total operating income to Kshs 25.0 bn in Q3’2022, from Kshs 20.2 bn in Q3’2021, which outpaced the 19.1% increase in the total operating expenses to Kshs 14.9 bn in Q3’2022, from Kshs 12.5 bn in Q3’2021,
- Total operating income rose by 24.0% to Kshs 25.0 bn in Q3’2022, from Kshs 20.2 bn in Q3’2021 mainly driven by a 15.6% increase in Net Interest Income (NII) to Kshs 16.2 bn, from Kshs 14.0 bn in Q3’2021 coupled with a 43.0% growth in Non-Funded Income (NFI) to Kshs 8.8 bn, from Kshs 6.2 bn in Q3’2021,
- Interest income rose by 17.3% to Kshs 26.8 bn in Q3’2022, from Kshs 22.8 bn in Q3’2021 driven by a 14.5% increase in interest income from loans and advances to Kshs 18.5 bn, from Kshs 16.2 bn in Q3’2021, coupled with a 21.3% increase in interest income from government securities to Kshs 7.9 bn, from Kshs 6.5 bn in Q3’2021. The Yield on Interest-Earning Assets increased by 0.7% points to 10.5%, from 9.8% in Q3’2021 due to the faster 19.6% growth in trailing interest income which outpaced the 10.9% growth in the average interest-earning assets. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense increased by 20.0% to Kshs 10.6 bn in Q3’2022, from Kshs 8.9 bn in Q3’2021, largely driven by a 13.8% growth in interest expense on customer deposits to Kshs 8.5 bn, from Kshs 7.5 bn in Q3’2021. Consequently, Cost of funds (COF) increased by 0.2% points to 4.2%, from 4.0% as recorded in Q3’2021, owing to the 18.8% rise in the trailing interest expense which outpaced the 11.6% increase in average interest bearing liabilities. On the other hand, Net Interest Margin (NIM) increased by 0.6% to 6.6% from 6.0% in Q3’2021, attributable to the 19.6% growth in the trailing net interest income which outpaced the 9.2% growth in average interest-earning assets (NII),
- Non-Funded Income increased by 43.0% to Kshs 8.8 bn in Q3’2022, from Kshs 6.2 bn in Q3’2021, mainly driven by a 219.6% increase in the foreign exchange trading income to Kshs 3.8 bn in Q3’2022 from Kshs 1.2 bn in Q3’2021 due to increased trading margins. Additionally, fees and commissions from loans and advances increased by 17.1% to Kshs 1.6 bn, from Kshs 1.4 bn in Q3’2021 in tandem with a 14.5% increase in Net loans and advances to Kshs 18.5 bn, from Kshs 16.2 bn in Q3’2021. I&M Group’s total fees and commissions increased by 26.0% to Kshs 4.3 bn in Q3’2022, from Kshs 3.4 bn in Q3’2021. As a result, the revenue mix shifted to 65:35 funded to non-funded income, from 69:31 funded to non-funded income in Q3’2021, owing to the 43.0% increase in NFI which outpaced the 15.6% growth in NII,
- Total operating expenses increased by 19.1% to Kshs 14.9 bn in Q3’2022, from Kshs 12.5 bn in Q3’2021, largely driven by a 10.2% increase in staff costs to Kshs 4.8 bn, from Kshs 4.3 bn in Q3’2021 coupled with a 21.8% increase in other operating expenses to Kshs 6.6 bn, from Kshs 5.4 bn in Q3’2021. Additionally, Loan Loss Provisions (LLP) increased by 27.5% to Kshs 3.6 bn, from Kshs 2.8 bn in Q3’2021, attributable to the relatively high non-performing loans,
- The Cost to Income Ratio (CIR) improved to 59.7% in Q3’2022, from 62.1% in Q3’2021 owing to the 24.0% increase in the total operating income which outpaced the 19.1% increase in the total operating expenses. Without LLP, the Cost to Income ratio improved as well to 45.3%, from 48.1% in Q3’2021, an indication of improving efficiency levels, and,
- Profit before tax and exceptional items rose by 28.9% to Kshs 10.4 bn, from Kshs 8.1 bn in Q3’2021, with the effective tax rate increasing to 31.2% in Q3’2022, from 29.1% seen in Q3’2021. Similarly, the Group recorded a 25.1% increase in profit after tax to Kshs 7.2 bn in Q3’2022, from Kshs 5.7 bn in Q3’2021.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 7.4% to Kshs 428.7 bn in Q3’2022, from Kshs 399.1 bn in Q3’2021, mainly attributable the 11.4% growth in net loans and advances to Kshs 231.2 bn in Q3’2022, from Kshs 207.6 bn in Q3’2021. However, government securities declined by 2.6% to Kshs 114.4 bn, from Kshs 117.5 bn recorded in Q3’2021, indicating a shift to increased lending as compared to allocation to government following the improving business conditions post-elections,
- Total liabilities grew by 8.7% to Kshs 355.2 bn, from Kshs 326.9 bn in Q3’2021, largely attributable to a 6.7% rise in customer deposits to Kshs 308.0 bn in Q3’2022, from Kshs 288.7 bn in Q3’2021 and a 67.8% growth in placements to Kshs 16.1 bn from Kshs 9.6 bn recorded in Q3’2021. However, borrowings declined by 8.1% to Kshs 18.7 bn from Kshs 20.3 bn in Q3’2021. Deposits per branch increased by 14.4% to Kshs 3.7 bn, from Kshs 3.2 bn in Q3’2021, with the number of branches reducing to 83 in Q3’2022, from 89 recorded in Q3’2021,
- The faster 11.4% growth in net loans and advances compared to the 6.7% growth in deposits, led to an increase in the loan to deposit ratio to 75.1%, from 71.9% in Q3’2021,
- Gross Non-Performing Loans (NPLs) increased by 4.2% to Kshs 23.7 bn in Q3’2022, from Kshs 22.7 bn in Q3’2021, partly attributable to its high exposure of loans advanced to manufacturing and trade sectors which accounted for 22.0% and 17.0% of the total loans from the group, respectively. Notably, the trading and manufacturing sectors continue to suffer from high non-performing loans, contributing 21.3% and 17.4% respectively of the total banking industry’s non-performing loans in Q2’2022. However, the NPL ratio reduced to 9.5% in Q3’2022, from 10.2% in Q3’2021, owing to the 11.4% growth in gross loans to Kshs 231.2 bn, from Kshs 207.6 bn in Q3’2021, which outpaced the 4.2% increase in gross non-performing loans. The improved asset quality is attributable to the continued economic recovery, improved business environment as well as the Group’s proactive credit management strategies,
- Provisions increased by 12.1% to Kshs 13.6 bn, from Kshs 12.1 bn in Q3’2021. The NPL coverage ratio consequently improved to 75.4% in Q3’2022, from 70.6% in Q3’2021, due to the faster 12.1% growth in provisions which outpaced the 4.2% increase in Gross Non-Performing Loans (NPLs),
- Shareholders’ funds increased slightly by 0.6% to Kshs 68.4 bn in Q3’2022, from Kshs 68.0 bn in Q3’2021, attributable to a 11.2% increase in the retained earnings to Kshs 47.2 bn, from Kshs 42.5 bn in Q3’2021. However, the increase in retained earnings was weighed down by the 881.4% increase in other reserves to Kshs 6.8 bn in Q3’2022 from Kshs 0.7 bn in Q3’2021,
- I&M Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.3%, 4.8% points above the statutory requirement of 10.5%. The total capital to risk-weighted assets ratio came in at 20.1%, exceeding the statutory requirement of 14.5% by 5.6% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 15.3%, while total capital to risk-weighted assets came in at 20.1%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.3%, and a Return on Average Equity (ROaE) of 13.9%.

Key Take-Outs:

1. **Improvement in Asset Quality** – The group’s asset quality improved, with the NPL ratio reducing to 9.5% in Q3’2022, from 10.2% in Q3’2021, owing to the 11.4% growth in gross loans to Kshs 231.2 bn, from Kshs 207.6 bn in Q3’2021, which outpaced the 4.2% increase in gross non-performing loans. The improved asset quality was attributable to the continued economic recovery which has seen more business pick up given that the group’s loan book constituted 71.0% and 19.0% corporate and business loans respectively as of Q3’2022. The group has also embarked on proactive credit management strategies that have seen increased loan repayments,
2. **Increase in Non-Funded Income-** Non-Funded Income increased by 43.0% to Kshs 8.8 bn in Q3’2022, from Kshs 6.2 bn in Q3’2021, mainly driven by a 219.6% increase in the foreign exchange trading income to Kshs 3.8 bn in Q3’2022 from Kshs 1.2 bn in Q3’2021 due to increased trading margins. Additionally,

fees and commissions from loans and advances increased by 17.1% to Kshs 1.6 bn, from Kshs 1.4 bn in Q3'2021 in tandem with a 14.5% increase in Net loans and advances to Kshs 18.5 bn, from Kshs 16.2 bn in Q3'2021. I&M Group's total fees and commissions increased by 26.0% to Kshs 4.3 bn in Q3'2022, from Kshs 3.4 bn in Q3'2021, and,

3. **Improved Efficiency** - The group enhanced their efficiency levels evidenced by an improvement in Cost to Income Ratio (CIR) improving to 59.7% in Q3'2022, from 62.1% in Q3'2021 owing to the 24.0% increase in the total operating income which outpaced the 19.1% increase in the total operating expenses. Without LLP, the Cost to Income ratio improved as well to 45.3%, from 48.1% in Q3'2021.

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

- I. **Technology:** The bank's continued concentration on digital channels for transactions will likely see it continue generating more profit, as they will continue to record increased usage and traffic. As of Q3'2022, 74.0% of the Group's transactions were executed digitally that saw the increase of the value of digital transactions to Kshs 1.2 bn in Q3'2022 from Kshs 308.0 mn in Q3'2021. Consequently, Non-Funded Income increased by 43.0% to Kshs 8.8 bn in Q3'2022, from Kshs 6.2 bn in Q3'2021, and,
- II. **Expansion to Retail and MSMEs lending:** In July 2022, the Bank signed a Credit Risk Guarantee scheme dubbed Nasira of amount USD 15.0 mn with the Dutch Entrepreneurial Development Bank to expand its outreach to Medium, Small and Micro Enterprises (MSMEs) as part of its 3-year Imara Strategy to expand to MSMEs and retail business. As the Kenya's banking sector has now given attention to financing MSMEs, we expect an increase in the Group's loaning to the MSME sector, that will continue to boost the Bank's profitability

Valuation Summary

- We are of the view that I&M Group is an "BUY" with a target price of Kshs 22.6, representing an upside of 33.2%, from the current price of Kshs 17.0 as of 25th November 2022,
- I&M Group's is currently trading at a P/TBV of 0.4x and a P/E of 3.0x vs an industry average of 0.8x and 4.6x, respectively.