

**Valuation Summary**

- We are of the view that I&M Holdings is a “Buy” with a target price of Kshs 151.2, representing an upside of 43.1%, from the current price of Kshs 108.0 as of 30<sup>th</sup> May, inclusive of a dividend yield of 3.1%,
- I&M Holdings is currently trading at P/TBV of 1.2x and a P/E of 6.8x vs an industry average of 1.7x and 10.3x, respectively.

**Key Highlights Q1'2018**

- I&M Holdings has completed a full buyout of Youjays Insurance Brokers for an undisclosed amount. This move was made in a bid to strengthen the Group’s bancassurance business. Youjays Insurance Brokers deals in both life and general insurance products and has been in operation since 1987. It has a portfolio of about Kshs 400 mn in premiums with a clientele of 400 firms,

**Income Statement**

- Core earnings per share increased by 1.8% to Kshs 18.5 from Kshs 18.1 in Q1'2017, which was below our expectation of a 6.7% increase to Kshs 19.4. Performance was driven by a 10.4% increase in total operating income, despite an 18.6% increase in the total operating expenses,
- Total operating income increased by 10.4% to Kshs 5.2 bn in Q1'2018 from Kshs 4.7 bn in Q1'2017. This was due to a 43.9% increase in Non-Funded Income (NFI) to Kshs 1.9 bn from Kshs 1.3 bn in Q1'2017, despite a 2.7% decline in Net Interest Income (NII) to Kshs 3.3 bn from Kshs 3.4 bn in Q1'2017,
- Interest income increased by 2.5% to Kshs 5.6 bn from Kshs 5.5 bn in Q1'2017. The interest income on loans and advances increased by 2.0% to Kshs 4.3 bn from Kshs 4.2 bn in Q1'2017, while interest income on government securities also increased by 5.9% to Kshs 1.4 bn from Kshs 1.3 bn in Q1'2017. The yield on interest earning assets however declined to 11.8% in Q1'2018 from 12.6% in Q1'2017, due to the relatively faster increase in the interest earning assets by 6.7% to Kshs 215.1 bn from Kshs 201.6 bn in Q1'2017, with the increase mainly being government securities that have a lower yield than loans,
- Interest expense increased by 10.9% to Kshs 2.3 bn from Kshs 2.1 bn in Q1'2017, as interest expense on customer deposits increased 11.3% to Kshs 2.0 bn from Kshs 1.8 bn in Q1'2017. Other interest expenses rose 9.1% to Kshs 237.7 mn from Kshs 217.9 mn in Q1'2017. The cost of funds declined to 4.8% from 5.0%. The Net Interest Margin declined to 7.4% from 8.1% in Q1'2017,
- Non-Funded Income increased by 43.9% to Kshs 1.9 bn from Kshs 1.3 bn in Q1'2017. The growth in NFI was driven by a 45.9% increase in total fees and commission income to Kshs 1.0 bn from Kshs 0.7 bn in Q1'2017, and a 104.7% increase in other income to Kshs 254.3 mn from Kshs 124.3 mn in Q1'2017. The fast increase in NFI has been supported by I&M’s acquisitions, having recently acquired Youjays Insurance brokerage to strengthen the bank’s bancassurance business, and a controlling stake in corporate finance advisory firm, Burbidge Capital, with these fee income businesses supporting growth of diversified revenue streams for the bank,
- The revenue mix currently stands at 63:37 funded to non-funded income, compared to 72:28 in Q1'2017, with the proportion of NFI to total income rising owing to an increase in NFI coupled with the decline in NII,
- Total operating expenses increased by 18.6% to Kshs 2.7 bn from Kshs 2.3 bn, largely driven by a 104.6% increase in loan loss provisions (LLP) to Kshs 578.4 mn from Kshs 282.7 mn in Q1'2017. The higher provisioning charge was necessitated given the sharp 134.4% increase in gross non-performing loans to Kshs 22.4 bn in Q1'2018 from Kshs 9.5 bn in Q1'2017, coupled with increased provisioning levels due to implementation of IFRS 9. Staff costs remained relatively flat, rising 0.6% to Kshs 992.3

mn from Kshs 985.9 mn in Q1'2017. Other operating expenses also rose 9.5% to Kshs 769.4 mn from Kshs 702.9 mn,

- The cost to income ratio deteriorated to 52.8% from 49.2% in Q1'2017. Without LLP, the Cost to income ratio improved to 41.6% from 43.1% in Q1'2017,
- Profit before tax increased by 1.9% to Kshs 2.6 bn, up from Kshs 2.5 bn in Q1'2017. Profit after tax increased 1.8% to Kshs 1.81 bn in Q1'2018 from Kshs 1.78 bn in Q1'2017,

### **Balance Sheet**

- The balance sheet recorded an expansion with total assets increasing by 6.2% to Kshs 246.3 bn from Kshs 231.9 bn in Q1'2017. This growth was largely driven by a 7.6% increase in the loan book to Kshs 152.7 bn from Kshs 142.0 bn in Q1'2017,
- Investment in government securities however declined by 1.7% to Kshs 51.3 bn from Kshs 52.2 bn in Q1'2017.
- Total liabilities rose by 5.6% to Kshs 198.6 bn from Kshs 188.0 bn in Q1'2017, driven by a 3.5% increase in total deposits to Kshs 171.7 bn from Kshs 165.9 bn in Q1'2017. Deposits per branch declined by 11.3% to Kshs 4.1 bn in Q1'2018 from Kshs 4.6 bn in Q1'2017, owing to the bank opening 4 new branches during the period,
- The faster growth in loans as compared to deposits led to an increase in the loan to deposit ratio to 88.9% from 85.6% in Q1'2017,
- Gross non-performing loans increased by 134.4% to Kshs 22.4 bn in Q1'2018 from Kshs 9.5 bn in Q1'2017. Consequently, the NPL ratio deteriorated to 13.8% in Q1'2018 from 6.5% in Q1'2017. Loan loss provisions increased by 70.7% to Kshs 5.3 bn from Kshs 3.1 bn in Q1'2017. Consequently, the NPL coverage decreased to 39.5% in Q1'2018 from 58.4% in Q1'2017, due to the relatively faster increase in the gross non-performing loans,
- Shareholders' funds increased by 8.4% to Kshs 44.9 bn in Q1'2018 from Kshs 41.4 bn in Q1'2017,
- I&M Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 17.2%, 6.7% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 19.2%, exceeding the statutory requirement by 4.7%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 17.3%, while total capital to risk weighted assets came in at 19.5%, indicating that the bank's total capital relative to its risk-weighted assets declined by 0.2% due to implementation of IFRS 9,
- I&M Holdings currently has a return on average assets of 3.0% and a return on average equity of 16.9%.

### **Key Take-Outs:**

1. I&M Holdings' NFI currently stands at 36.5%, which is above the industry average of 33.6%. The higher NFI contribution to total income has been supported through the acquisitions of fee income businesses like Youjays Insurance brokers and Burbidge capital, to diversify I&M's sources of generating revenue.
2. The bank saw a deterioration in its Cost-to-income ratio to 52.8% from 49.2% in Q1'2017. This is a pointer to the bank's efforts to improve operational efficiencies in the company's operations such as automation of processing centers, investment in alternative channels and branch rationalization programs.
3. The bank experienced a deterioration in asset quality, with gross non-performing loans (NPLs) rising by 134.4%, to Kshs 22.4 bn from Kshs 9.5 bn in Q1'2017. However, provisioning levels failed to rise in tandem, increasing by 70.7%, leading to a decline in the NPL coverage to 39.5% in Q1'2018 from 58.4% in Q1'2017

We expect the bank's growth to be further driven by:

- I&M Holdings experienced a deterioration in asset quality, with gross non-performing loans (NPLs) 134.4% to Kshs 22.4 bn in Q1'2018 from Kshs 9.5 bn in Q1'2017. Consequently, the NPL ratio deteriorated to 13.8% in Q1'2018 from 6.5% in Q1'2017. The bank needs to adopt initiatives that will aid to improve the asset quality of the bank, and consequently reduce the loan-loss provision expense.
- The continued revenue diversification strategies, which have seen I&M Holdings venture into bancassurance and corporate finance and advisory business through various acquisitions. These strategies should contribute positively to the bank's diversification strategy and growth in non-funded income.

Balance Sheet Items	Q1'2017	Q1'2018	y/y change	Q1'2018e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	52.2	51.3	(1.7%)	51.8	(0.7%)	(1.0%)
Net Loans and Advances	142.0	152.7	7.6%	155.4	9.5%	(1.9%)
<b>Total Assets</b>	<b>231.9</b>	<b>246.3</b>	<b>6.2%</b>	<b>245.7</b>	<b>6.0%</b>	<b>0.3%</b>
Customer Deposits	165.9	171.7	3.5%	172.7	4.1%	(0.6%)
Total Liabilities	188.0	202.7	7.8%	196.6	4.6%	3.2%
<b>Shareholders' Funds</b>	<b>41.4</b>	<b>44.9</b>	<b>8.4%</b>	<b>46.4</b>	<b>12.1%</b>	<b>(3.6%)</b>

Balance Sheet Ratios	Q1'2017	Q1'2018	y/y change
Loan to Deposit Ratio	85.6%	88.9%	3.4%
Return on average equity	18.3%	16.9%	(1.4%)
Return on average assets	3.2%	3.0%	(0.1%)

Income Statement	Q1'2017	Q1'2018	y/y change	Q1'2018e	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	3.4	3.3	(2.7%)	3.1	(7.8%)	5.1%
Net non-Interest Income	1.3	1.9	43.9%	2.0	53.0%	(9.1%)
Total Operating income	4.7	5.2	10.4%	5.1	9.2%	1.1%
Loan Loss provision	(0.3)	(0.6)	104.6%	(0.5)	63.6%	40.9%
Total Operating expenses	(2.3)	(2.7)	18.6%	(2.4)	5.3%	13.3%
Profit before tax	2.5	2.6	1.9%	2.7	7.0%	(5.2%)
<b>Profit after tax</b>	<b>1.8</b>	<b>1.8</b>	<b>1.8%</b>	<b>1.9</b>	<b>6.7%</b>	<b>(4.9%)</b>

Income Statement Ratios	Q1'2017	Q1'2018	y/y change
Yield from interest-earning assets	12.6%	11.8%	(0.8%)
Cost of funding	5.0%	4.8%	(0.3%)
Net Interest Margin	8.1%	7.4%	(0.7%)
Cost to Income	49.2%	52.8%	3.7%
Cost to Assets	1.0%	1.1%	0.1%
Net Interest Income as % of operating income	72.0%	63.5%	(8.5%)
Non-Funded Income as a % of operating income	28.0%	36.5%	8.5%

Capital Adequacy Ratios	Q1'2017	Q1'2018
Core Capital/Total Liabilities	31.4%	23.6%
Minimum Statutory ratio	8.0%	8.0%
<b>Excess</b>	<b>23.4%</b>	<b>15.6%</b>
Core Capital/Total Risk Weighted Assets	24.4%	17.2%
Minimum Statutory ratio	10.5%	10.5%
<b>Excess</b>	<b>13.9%</b>	<b>6.7%</b>
Total Capital/Total Risk Weighted Assets	26.5%	19.2%
Minimum Statutory ratio	14.5%	14.5%
<b>Excess</b>	<b>12.0%</b>	<b>4.7%</b>
Liquidity Ratio	39.3%	39.9%
Minimum Statutory ratio	20.0%	20.0%
<b>Excess</b>	<b>19.3%</b>	<b>19.9%</b>
<b>Adjusted Core Capital/Total Liabilities</b>		<b>23.7%</b>
<b>Adjusted Core Capital/Total Risk Weighted Assets</b>		<b>17.3%</b>
<b>Adjusted Total Capital/Total Risk Weighted Assets</b>		<b>19.5%</b>