

Valuation Summary

- We are of the view that I&M Holdings Plc is a “**buy**” with a target price of Kshs 83.9, representing an upside of 53.2%, from the current price of Kshs 57.0 as of 31st May 2019, inclusive of a dividend yield of 6.1%,
- I&M Holdings Plc is currently trading at a P/TBV of 1.1x and a P/E of 5.6x vs an industry average of 1.2x and 6.3x, respectively.

Income Statement

- During the week, I&M Holdings released their financial results with core earnings per share increasing by 30.5% to Kshs 5.7, from Kshs 4.4 in Q1'2018, higher than our projections of a 28.2% increase to Kshs 5.6. The performance was driven by a 4.9% increase in total operating income, coupled with a 10.9% decline in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 10.9% decline in total operating expenses to Kshs 2.4 bn, from Kshs 2.7 bn in Q1'2018, against our expectations of a 5.2% rise. However, after adjusting for the bonus issue of 1:1 that was issued during the quarter, core earnings per share came in at to Kshs 2.9.
- Total operating income increased by 4.9% to Kshs 5.4 bn, from Kshs 5.2 bn in Q1'2018. This was driven by a 9.7% increase in Non-Funded Income (NFI) to Kshs 2.1 bn, from Kshs 1.9 bn, coupled with a 2.1% increase in Net Interest Income (NII) to Kshs 3.34 bn, from Kshs 3.27 bn in Q1'2018,
- Interest income increased by 8.9% to Kshs 6.1 bn, from Kshs 5.6 bn in Q1'2018. This was driven by a 16.8% growth in interest income from loans and advances to Kshs 5.0 bn, from Kshs 4.2 bn in Q1'2018. Interest income on government securities recorded a 23.7% decline to Kshs 1.0 bn, from Kshs 1.4 bn in Q1'2018. The yield on interest-earning assets however declined to 11.2%, from 11.8% in Q1'2018, following a faster 19.6% rise in interest earning assets that outpaced the 8.9% rise in interest income. Moreover, a decline in yields on government securities as well as a decline in lending rates due to the two Central Bank Rate (CBR) cuts in 2018 contributed to the decline in the yield. Consequently, the Net Interest Margin (NIM) declined to 6.1%, from 7.4% in Q1'2018,
- Interest expense increased by 18.2% to Kshs 2.8 bn, from Kshs 2.3 bn in Q1'2018, following a 19.6% increase in the interest expense on customer deposits to Kshs 2.4 bn, from Kshs 2.0 bn in Q1'2018. Consequently, the cost of funds rose to 5.0%, from 4.8% in Q1'2018,
- Non-Funded Income rose by 9.7% to Kshs 2.1 bn, from Kshs 1.9 bn in Q1'2018. The increase was mainly due to a 15.6% rise in fees and commissions on loans to Kshs 388.9 mn, from Kshs 336.4 mn in Q1'2018. In addition, FX trading income increased by 8.7% to Kshs 645.3 mn, from Kshs 593.7 mn in Q1'2018. The revenue mix shifted to 62:38 funded to non-funded income, from 63:37, owing to the high growth in NFI that outpaced growth in NII,
- Total operating expenses declined by 10.9% to Kshs 2.4 bn, from Kshs 2.7 bn in Q1'2018, largely driven by a 65.5% decline in Loan Loss provisions (LLP) to Kshs 199.4 mn, from Kshs 578.4 mn in Q1'2018. Staff costs however recorded a 13.4% rise to Kshs 1.1 bn, from Kshs 992.3 mn in Q1'2018,
- The Cost to Income Ratio (CIR) improved to 44.9%, from 52.8% in Q1'2018. Without LLP, the cost to income ratio improved as well, to 41.2% from 41.6% in Q1'2018, and,
- Profit before tax increased by 27.8% to Kshs 3.3 bn, up from Kshs 2.6 bn in Q1'2018. Profit after tax grew by 30.5% to Kshs 2.4 bn in Q1'2019, from Kshs 1.8 bn in Q1'2018, with the effective tax rate declining to 27.5%, from 29.0% in Q1'2018.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 21.6% to Kshs 299.6 bn, from Kshs 246.3 bn in Q1'2018. Growth was supported by a 36.4% growth in property and equipment to Kshs 7.8 bn, from Kshs 5.7 bn in Q1'2018, coupled with a 10.6% growth in net loans to Kshs 168.9 bn, from Kshs 152.7 bn in Q1'2018, and an 8.2% increase in government securities to Kshs 55.5 bn, from Kshs 51.3 bn in Q1'2018,
- Total liabilities rose by 24.1% to Kshs 246.5 bn, from Kshs 198.6 bn in Q1'2018, driven by a 28.8% increase in customer deposits to Kshs 221.2 bn, from Kshs 171.7 bn in Q1'2018. Deposits per branch increased by 32.0% to Kshs 5.4 bn from Kshs 4.1 bn in Q1'2018, as the number of branches declined by 1 to 41 branches, from 42 in Q1'2018,
- The faster growth in deposits compared to the growth in loans led to a decline in the loan to deposit ratio to 76.4%, from 88.9% in Q1'2018,
- Gross Non-Performing Loans (NPLs) increased by 6.1% to Kshs 23.7 bn, from Kshs 22.4 bn in Q1'2018. The NPL ratio however improved to 13.0% from 13.8% in Q1'2018 due to the faster growth in gross loans that outpaced the growth in Gross Performing Loans (NPLs). General Loan Loss Provisions increased by 32.7% to Kshs 7.1 bn from Kshs 5.3 bn in Q1'2018. Thus, the NPL coverage improved to 57.4% in Q1'2019 from 39.5% in Q1'2018,
- Shareholders' funds increased by 11.7% to Kshs 50.1 bn in Q1'2018, from Kshs 44.9 bn in Q1'2018, supported by a 20.5% increase in retained earnings to Kshs 29.3 bn, from Kshs 24.3 bn,
- I&M Holdings remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.3%, 5.8% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 18.7%, exceeding the statutory requirement by 4.2% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 16.5%, while total capital to risk-weighted assets came in at 18.9%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.0%, and a Return on Average Equity (ROaE) of 17.8%.

Key Take-Outs:

1. The bank maintained its continual rise in NFI recording a 9.7% rise to Kshs 2.1 bn from Kshs 1.9 bn in Q1'2018. This resulted in the revenue contribution mix shifting to 67:33 funded to non-funded income, from 73:27, owing to the high growth in NFI that outpaced growth in NII, and,
2. The bank's asset quality improved, with the NPL ratio declining to 13.0% from 13.8% in Q1'2018. NPL coverage also improved to 57.4% up from 39.5% in Q1'2018, as the 32.7% rise in provisions to Kshs 7.1 bn from Kshs 5.3 bn in Q1'2018 outpaced the 6.1% growth in gross NPL to Kshs 23.7 bn in Q1'2019, from Kshs 22.4 bn in Q1'2018.

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

- I. Non-Funded Income 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, and,
- II. 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.

Balance Sheet (mns)	Q1'2018	Q1'2019	y/y change	Q1'2018e	Expected y/y change	Variance in Actual Growth vs. Expected
Net Loans and Advances	152,691.5	168,936.7	10.6%	167,655.4	9.8%	0.8%
Total Assets	246,327.1	299,624.2	21.6%	298,164.3	21.0%	0.6%
Customer Deposits	171,667.7	221,169.2	28.8%	220,599.2	28.5%	0.3%
Total Liabilities	198,581.2	246,453.3	24.1%	245,107.5	23.4%	0.7%
Shareholders' Funds	44,891.9	50,128.3	11.7%	50,051.4	11.5%	0.2%

Balance sheet ratios	Q1'2018	Q1'2019	% y/y change
Loan to Deposit Ratio	88.9%	76.4%	(12.6%)
Return on average equity	15.7%	17.8%	2.1%
Return on average assets	2.8%	3.0%	0.1%

Income Statement(mns)	Q1'2018	Q1'2019	y/y change	Q1'2018e	Expected y/y change	Variance in Actual Growth vs. Expected
Net Interest Income	3,272.0	3,341.9	2.1%	3,646.2	11.4%	(9.3%)
Net non-Interest Income	1,881.0	2,064.1	9.7%	1,941.0	3.2%	6.5%
Total Operating income	5,153.0	5,405.9	4.9%	5,587.2	8.4%	(3.5%)
Loan Loss provision	(578.4)	(199.4)	(65.5%)	(635.3)	9.8%	(75.4%)
Total Operating expenses	(2,722.9)	(2,426.3)	(10.9%)	(2,864.1)	5.2%	(16.1%)
Profit before tax	2,552.7	3,263.3	27.8%	3,318.4	30.0%	(2.2%)
Profit after tax	1,812.3	2,364.9	30.5%	2,322.8	28.2%	2.3%
Core EPS	4.4	5.7	30.5%	5.6	28.2%	2.3%

Income statement ratios	Q1'2018	Q1'2019	% y/y change
Yield from interest-earning assets	2.7%	2.6%	(0.1%)
Cost of funding	1.2%	1.2%	(0.1%)
Net Interest Margin	7.4%	6.1%	(1.3%)
Cost to Income	52.8%	44.9%	(8.0%)
Cost to Assets	1.1%	0.8%	(0.3%)
Net Interest Income as % of operating income	63%	62%	(1.7%)
Non-Funded Income as a % of operating income	37%	38%	1.7%

Capital Adequacy Ratios	Q1'2018	Q1'2019
Core Capital/Total Liabilities	23.6%	21.0%
Minimum Statutory ratio	8.0%	8.0%
Excess	15.6%	13.0%
Core Capital/Total Risk Weighted Assets	17.2%	16.3%
Minimum Statutory ratio	10.5%	10.5%
Excess	6.7%	5.8%
Total Capital/Total Risk Weighted Assets	19.2%	18.7%
Minimum Statutory ratio	14.5%	14.5%
Excess	4.7%	4.2%
Liquidity Ratio	39.5%	46.5%
Minimum Statutory ratio	20.0%	20.0%
Excess	19.5%	26.5%
Adjusted Core Capital/Total Liabilities	23.6%	20.6%
Adjusted Core Capital/Total RWA	17.3%	16.5%

Adjusted Total Capital/Total RWA	19.5%	18.9%
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