

Valuation Summary

- We are of the view that I&M Holdings Plc is a “**BUY**” with a target price of Kshs 138.6, representing an upside of 29.5%, from the current price of Kshs 110.0 as of 28th March 2019, inclusive of a dividend yield of 3.5%,
- 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 1.5x and 7.0x, respectively.

Key Highlights FY'2018

- I&M Bank Limited, through its wholly owned subsidiary, I&M Insurance Agency Limited (IMIAl) completed the acquisition of Youjays Insurance Brokers Limited (YIB). The bank acquired 100.0% of the shareholding of the insurance broking firm, simultaneously merging its operations with the Group's Bancassurance division. The acquisition underpins the Group's efforts in expanding revenue streams for its non-funded income portfolio in line with its iMara corporate strategy. The bank's insurance is expected to benefit from additional capacity and expertise to grow the Bancassurance business, which provides brokerage services for personal and commercial lines;
- I&M Bank Kenya was granted a 5-year loan of USD 40 mn (Kshs 4.0 bn) from Dutch Development Bank FMO, to boost lending to small and medium-sized enterprises in the country.

Income Statement

- Core earnings per share increased by 17.1% to Kshs 20.6, from Kshs 17.6 in FY'2017, higher than our projections of a 15.3% increase to Kshs 20.3. The performance was driven by an 8.8% increase in total operating income, which outpaced the 2.6% increase in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 2.6% rise in total operating expenses to Kshs 12.3 bn, from Kshs 12.0 bn in FY'2017, which was slower than our expectation of a 5.9% rise,
- Total operating income increased by 8.8% to Kshs 23.2 bn, from Kshs 21.3 bn in FY'2017. This was driven by a 31.8% increase in Non-Funded Income (NFI) to Kshs 7.6 bn from Kshs 5.8 bn in FY'2017, coupled with a 0.3% increase in Net Interest Income (NII) to Kshs 15.6 bn from Kshs 15.55 bn in FY'2017,
- Interest income increased by 6.4% to Kshs 26.0 bn from Kshs 24.4 bn in FY'2017. This was driven by a 9.7% growth in interest income from loans and advances to Kshs 20.7 bn, from Kshs 18.9 bn in FY'2017. Interest income on government securities recorded a 7.4% decline to Kshs 5.0 bn from Kshs 5.4 bn in FY'2017. The yield on interest-earning assets however declined to 11.6%, from 12.3% in FY'2017, attributed to 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. Consequently, the Net Interest Margin (NIM) declined to 7.0%, from 7.9% in FY'2017 on account of lower yield on interest earning assets,
- Interest expense increased by 17.3% to Kshs 10.4 bn, from Kshs 8.9 bn in FY'2017, following a 16.2% increase in the interest expense on customer deposits to Kshs 8.8 bn, from Kshs 7.6 bn in FY'2017, coupled with a 57.5% increase in interest expense on placements to Kshs 584.7 mn from Kshs 371.3 mn in FY'2017. Other interest expenses also increased by 10.1% to Kshs 1.0 bn from Kshs 926.1 mn in FY'2017. Despite the higher interest expenses, the cost of funds declined to 4.9% from 5.0% in FY'2017, owing to a faster increase in interest bearing liabilities that rose by 23.7% to Kshs 232.5 bn from Kshs 187.9 bn in FY'2017 that outpaced the growth in interest expense,
- Non-Funded Income rose by 31.8% to Kshs 7.6 bn from Kshs 5.8 bn in FY'2017. The increase was mainly due to a 59.1% increase in fees and commissions on loans to Kshs 1.8 bn from Kshs 1.1 bn in FY'2017. In addition, the FX trading income increased by 40.4% to Kshs 2.6 bn from Kshs 1.8 bn in FY'2017. The revenue

mix shifted to 67:33 funded to non-funded income, from 73:27, owing to the high growth in NFI that outpaced growth in NII,

- Total operating expenses rose by 2.6% to Kshs 12.3 bn from Kshs 12.0 bn in FY'2017, largely driven by a 9.7% increase in staff costs to Kshs 4.1 bn from Kshs 3.7 bn in FY'2017, with the rise being mitigated by an 8.1% decline in Loan Loss Provisions (LLP) to Kshs 3.8 bn from Kshs 4.1 bn in FY'2017,
- The Cost to Income Ratio (CIR) improved to 53.0%, from 56.2% in FY'2017. Without LLP, the cost to income ratio improved as well to 36.6% from 36.8% in FY'2017,
- Profit before tax increased by 16.2% to Kshs 11.5 bn, up from Kshs 9.9 bn in FY'2017. Profit after tax grew by 17.1% to Kshs 8.5 bn in FY'2018, from Kshs 7.3 bn in FY'2017, with the effective tax rate declining to 30.5%, from 34.7% in FY'2017,
- The directors did not recommend payment of a final dividend having paid an interim dividend of Kshs 3.90 for the year ending FY'2018, to be paid in 23rd May 2019. This total dividend paid is an 11.4% increase from Kshs 3.5 paid in FY'2017, which translates to a dividend yield of 3.5% and a dividend payout ratio of 19.0%. The Board has resolved to recommend the issuance of a bonus share of one (1) new fully paid up bonus share of a par value Kshs 1.00 for every one (1) ordinary shares of par value Kshs 1.00 to be issued to the shareholders registered on the Company's register at the close of business on 10th May 2019. The issue is possible to improve the liquidity of the company's share in the NSE. If successful, the bonus issue will see investors double their shares in I&M holdings PLC which effectively will also result in a decline in the Bank's EPS.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 20.2% to Kshs 288.5 bn, from Kshs 240.1 bn in FY'2017. Growth was supported by a 25.1% increase in cash and bank balances to Kshs 14.9 bn from Kshs 11.9 bn in FY'2017, and a 26.0% growth in property and equipment to Kshs 6.7 bn from Kshs 5.3 bn in FY'2017,
- The loan book recorded a 9.0% growth to Kshs 166.7 bn, from Kshs 153.0 bn in FY'2017. Government securities however recorded a 21.8% decline to Kshs 39.0 bn from Kshs 49.9 bn in FY'2017,
- Total liabilities rose by 23.1% to Kshs 237.6 bn, from Kshs 193.1 bn in FY'2017, driven by a 25.9% increase in customer deposits to Kshs 213.1 bn from Kshs 169.3 bn in FY'2017. Deposits per branch increased by 29.0% to Kshs 5.2 bn from Kshs 4.0 bn in FY'2017, with the number of branches declining by 1 to 41 branches,
- Borrowings increased by 8.6% to Kshs 13.8 bn from Kshs 12.7 bn in FY'2017,
- The faster growth in deposits as compared to the growth in loans led to a decline in the loan to deposit ratio to 78.2% from 90.4% in FY'2017,
- Gross Non-Performing Loans (NPLs) increased by 22.3% to Kshs 23.8 bn in FY'2018, from Kshs 19.5 bn in FY'2017. The NPL ratio thus deteriorated to 13.2% from 12.1% in FY'2017. General Loan Loss Provisions increased by 51.8% to Kshs 8.0 bn from Kshs 5.3 bn in FY'2017. Thus, the NPL coverage improved to 56.5% in FY'2018 from 40.0% in FY'2017,
- Shareholders' funds increased by 8.0% to Kshs 47.9 bn in FY'2018 from Kshs 44.3 bn in FY'2017, supported by a 19.1% increase in retained earnings to Kshs 26.9 bn from Kshs 22.6 bn,
- I&M Holdings Plc remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.1%, 5.6% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 18.2%, exceeding the statutory requirement by 3.7% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 16.6%, while total capital to risk-weighted assets came in at 18.8%.
- The bank currently has a Return on Average Assets (ROaA) of 3.2%, and a Return on Average Equity (ROaE) of 18.4%.

Key Take-Outs:

1. The bank recorded a 31.8% rise in NFI, which is currently the highest amongst the listed banks in FY'2018. This was despite the implementation of the Effective Interest Rate (EIR) under IFRS 9, which has seen the bank amortize fees charged on loans over the future period of a loan's tenor leading to a decline in NFI's in FY'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,
2. The bank's asset quality deteriorated, with the NPL ratio deteriorating to 13.2% from 12.1% in FY'2017. NPL coverage however improved to 56.5% up from 40.0% in FY'2017, as the 51.8% rise in provisions to Kshs 8.0 bn from Kshs 5.3 bn outpaced the 22.3% growth in gross NPL to Kshs 23.8 bn, from Kshs 19.5 bn in FY'2017.

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. The acquisition of Youjays Insurance Brokers provides the bank with an avenue to grow its bancassurance business, thereby putting the firm's NFI on a positive growth trajectory.
- 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.

Below is a summary of the bank's performance:

Balance Sheet	FY'2017	FY'2018	y/y change	FY'2018e	Expected y/y change	Variance in Actual Growth vs. Expected
Net Loans and Advances	153.0	166.7	9.0%	166.6	8.8%	0.1%
Total Assets	240.1	288.5	20.2%	293.8	22.3%	(2.2%)
Customer Deposits	169.3	213.1	25.9%	212.2	25.3%	0.6%
Total Liabilities	193.1	237.6	23.1%	243.0	25.8%	(2.7%)
Shareholders Funds	44.3	47.9	8.0%	48.1	8.4%	(0.4%)

Balance sheet ratios	FY'2017	FY'2018	% y/y change
Loan To Deposit Ratio	90.4%	78.2%	(12.2%)
Return On Average Equity	16.6%	18.4%	1.8%
Return On Average Assets	3.0%	3.2%	0.2%

Income Statement	FY'2017	FY'2018	y/y change	FY'2018e	Expected y/y change	Variance in Actual Growth vs. Expected
Net Interest Income	15.6	15.6	0.3%	16.2	4.3%	(4.0%)
Net Non-Interest Income	5.8	7.6	31.8%	7.9	37.6%	(5.8%)
Total Operating Income	21.3	23.2	8.8%	24.1	13.3%	(4.5%)
Loan Loss Provision	(4.1)	(3.8)	(8.1%)	(3.8)	(7.4%)	(0.7%)
Total Operating Expenses	(12.0)	(12.3)	2.6%	(12.7)	5.9%	(3.3%)
Profit Before Tax	9.9	11.5	16.2%	12.0	20.9%	(4.7%)
Profit After Tax	7.3	8.5	17.1%	8.4	15.3%	1.7%
Core EPS	17.6	20.6	17.1%	20.3	15.3%	1.7%

Income Statement Ratios	FY'2017	FY'2018	% y/y change
Yield from Interest-Earning Assets	12.3%	11.6%	(0.7%)
Cost of Funding	4.8%	4.5%	(0.3%)
Net Interest Margin	7.9%	7.0%	(0.9%)
Cost to Income	56.2%	53.0%	(3.2%)
Cost to Assets	5.0%	4.3%	(0.7%)
Net Interest Income as % Of Operating Income	73%	67%	(5.7%)
Non-Funded Income as A % Of Operating Income	27%	33%	5.7%

Capital Adequacy Ratios	FY'2017	FY'2018
Core Capital/Total Liabilities	19.2%	20.2%
Minimum Statutory ratio	8.0%	8.0%
Excess	11.2%	12.2%
Core Capital/Total Risk Weighted Assets	16.2%	15.3%
Minimum Statutory ratio	10.5%	10.5%
Excess	5.7%	4.8%
Total Capital/Total Risk Weighted Assets	18.2%	16.9%
Minimum Statutory ratio	14.5%	14.5%
Excess	3.7%	2.4%
Liquidity Ratio	39.5%	47.8%
Minimum Statutory ratio	20.0%	20.0%
Excess	19.5%	27.8%
Adjusted Core Capital/Total Liabilities		22.1%
Adjusted Core Capital/Total RWA		16.6%
Adjusted Total Capital/Total RWA		18.8%