

Valuation Summary

- We are of the view that I&M Holdings Plc is a “**BUY**” with a target price of Kshs 64.3, representing an upside of 48.4%, from the current price of Kshs 43.4 as of 28th August 2020, inclusive of a dividend yield of 5.9%,
- I&M Holdings Plc is currently trading at a P/TBV of 0.7x and a P/E of 4.0x vs an industry average of 0.6x and 5.2x, respectively.

Key Highlights H1'2020

- I&M Holdings plc issued a cautionary statement to its shareholders in July 2020 on its intention to acquire 90.0% of the share capital of Orient Bank Limited Uganda (OBL). The proposed transaction will be subject to approval from the Central Bank of Kenya, Central Bank of Uganda, the Capital Markets Authority and the company shareholders. The transaction will see I&M spend more than Kshs 2.0 bn in the acquisition of the Ugandan Bank.

Income Statement

- Core earnings per share declined by 29.5% to Kshs 3.9, from Kshs 5.5 in H1'2019, not in line with our projections of an 8.6% decline to Kshs 5.0. The performance was driven by a 3.6% decline in total operating income and a 5.5% increase in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 3.6% decline in total operating income to Kshs 11.1 bn, from Kshs 11.6 bn in H1'2019, with the drop being faster than our expectation of a 2.8% drop,
- Total operating income was down by 3.6% to Kshs 11.1 bn, from Kshs 11.6 bn in H1'2019. This was driven by a 7.1% decline in Non-Funded Income (NFI) to Kshs 4.2 bn, from Kshs 4.5 bn in H1'2019, coupled with a 1.4% decline in Net Interest Income (NII) to Kshs 6.9 bn, from Kshs 7.0 bn in H1'2019,
- Interest income rose by 3.4% to Kshs 13.1 bn, from Kshs 12.7 bn in H1'2019. This was driven by a 5.0% increase in interest income from Loans and Advances to 10.8 bn from 10.2 bn in H1'2019, as well as, a 0.7% growth in interest income from government securities to Kshs 2.15 bn from Kshs 2.13 bn in H1'2019. The yield on interest-earning assets declined to 9.8%, from 10.4% in H1'2019, largely attributable to a faster 8.3% increase in average interest earning assets as compared to the 3.4% growth in Interest Income,
- Interest expense rose by 9.4% to Kshs 6.2 bn, from Kshs 5.7 bn in H1'2019, following a 6.4% rise in Interest expense on deposits to Kshs 5.4 bn from Kshs 5.1 bn in H1'2019, coupled with a 224.8% increase in the interest expense on placements to Kshs 0.4 bn, from Kshs 0.1 bn in H1'2019, which outpaced the 8.6% decline in other interest expenses to Kshs 0.4 bn from Kshs 0.5 bn in H1'2019. Cost of funds declined marginally to 4.6% from 4.7% in H1'2019, owing to a faster 8.6% increase in average interest-bearing liabilities, to Kshs 263.5 bn from Kshs 242.6 bn in H1'2019 that outpaced the 8.0% growth in trailing interest expense. Net Interest Margin (NIM) on the other hand declined to 5.3%, from 6.0% in H1'2019 due to the 1.4% increase in NII, that was outpaced by the 8.3% increase in average interest-earning assets,
- Non-Funded Income declined by 7.1% to Kshs 4.2 bn, from Kshs 4.5 bn in H1'2019. The decline was mainly due to a 27.0% decline in Foreign Exchange Trading income to Kshs 0.9 bn from Kshs 1.3 bn in H1'2019 coupled with a 10.4% decline in other fees and commissions income to Kshs 1.1 bn from Kshs 1.2 bn in H1'2019. Income from fees and commissions on loans and advances however increased by 7.7% to Kshs 959.4 mn from Kshs 890.9 mn in H1'2019. The revenue mix shifted to 62:38 funded to non-funded income, from 61:39, owing to the faster 7.1% decline in NFI, compared to the 1.4% decline in NII,
- Total operating expenses rose by 5.5% to Kshs 6.1 bn from Kshs 5.7 bn in H1'2019, largely driven by a 17.2% increase in other operating expenses to Kshs 2.7 bn from Kshs 2.3 bn in H1'2019. The decline was however weighed down by the 7.0% decline in Loan Loss Provisions (LLP) to Kshs 1.0 bn from Kshs 1.1 bn in H1'2019, coupled with marginal declines of 0.04% in Staff costs to Kshs 2.325 bn from Kshs 2.326 bn in H1'2019,
- Cost to Income Ratio (CIR), with LLP deteriorated to 54.4%, from 49.7% in H1'2019. Without LLP, cost to income ratio deteriorated as well to 45.1% from 40.1% in H1'2019, an indication of reduced efficiency,

- Profit before tax declined by 27.7% to Kshs 4.5 bn, down from Kshs 6.2 bn in H1'2019. Profit after tax declined by 29.5% to Kshs 3.2 bn in H1'2020 from Kshs 4.5 bn in H1'2019, with the effective tax rate increasing to 29.1%, from 27.2% in H1'2019,

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 7.4% to Kshs 340.6 bn, from Kshs 317.1 bn in H1'2019. Growth was supported by a 30.1% increase in government securities to Kshs 72.2 bn from Kshs 55.5 bn in H1'2019, coupled with a 7.2% loan book expansion to Kshs 184.6 bn from Kshs 172.2 bn in H1'2019. Placements on the other hand declined by 19.8% to Kshs 35.2 bn from Kshs 44.0 bn in H1'2019,
- Total liabilities rose by 6.5% to Kshs 278.6 bn, from Kshs 261.6 bn in H1'2019, driven by a 23.8% increase in placements to Kshs 9.5 bn from Kshs 7.6 bn in H1'2019, coupled with a 6.6% rise in customer deposits to Kshs 252.5 bn from Kshs 237.2 bn in H1'2019. Deposits per branch increased by 8.6% to Kshs 3.8 bn from Kshs 3.5 bn in H1'2019, with the number of branches remaining unchanged at 67,
- The slower 6.6% growth in deposits as compared to the 7.2% growth in loans led to a increase in the loan to deposit ratio to 73.1% from 72.6% in H1'2019,
- Gross non-performing loans declined by 9.4% to Kshs 22.1 bn in H1'2020 from Kshs 24.4 bn in H1'2019. Consequently, the NPL ratio, improved to 11.0% in H1'2020 from 13.0% in H1'2019 as the 9.4% decline in Non-Performing Loans, despite a 5.9% growth in gross loans. The NPL coverage improved to 63.1% in H1'2020 from 62.4% in H1'2019, as general Loan Loss Provisions increased by 17.4% to Kshs 9.8 bn from Kshs 8.3 bn in H1'2019, despite a 9.4% decline in gross non-performing loans,
- Shareholders' funds increased by 12.1% to Kshs 58.7 bn in H1'2020, from Kshs 52.4 bn in H1'2019, supported by an 9.5% increase in retained earnings to Kshs 33.4 bn, from Kshs 30.5 bn,
- I&M Holdings Plc 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 21.4%, exceeding the statutory requirement by 6.9% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 16.4%, while total capital to risk-weighted assets came in at 21.5%.
- The bank currently has a Return on Average Assets (ROaA) of 2.7%, and a Return on Average Equity (ROaE) of 15.4%

Key Take-Outs:

- Despite the weakened business environment on account of the COVID-19 pandemic, the bank took a less conservative stance in its provisioning levels as Loan Loss Provisions (LLP) declined by 7.0% to Kshs 1.0 bn from Kshs 1.1 bn in H1'2019,
- The bank's asset quality improved, with the NPL ratio improving to 11.0%, from 13.0% in H1'2019. NPL coverage also improved to 63.1%, up from 62.4% in H1'2019 as the 17.4% rise in general provisions to Kshs 9.8 bn, from Kshs 8.3 bn in H1'2019, outpaced the 9.4% decline in gross NPL to Kshs 22.1 bn in H1'2020 from Kshs 24.4 bn in H1'2019, and,
- There was a decline in efficiency levels as the cost to income ratio without LLP worsened to 45.1% from 40.1% in H1'2020, an indication of reduced efficiency.

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

- Geographical Diversification – The bank has been aggressively expanding into other regions, namely Tanzania, Rwanda, and Uganda. On this front, the bank is set to acquire 90.0% of the share capital of Orient Bank Limited Uganda (OBL). This will see the bank expand its operations in the Ugandan Market thus reducing its reliance on the Kenyan Market. This is also expected to drive growth in the near future.

Below is a summary of the bank's performance:

Balance Sheet	H1'19 Kshs bn	H1'20 Kshs bn	y/y change	H1'2020 e	Expected y/y change	Variance in Actual Growth vs. Expected
Government Securities	55.5	72.2	30.1%	58.6	5.6%	(24.5%)

Net Loans and Advances	172.2	184.6	7.2%	178.4	3.6%	(3.6%)
Total Assets	317.1	340.6	7.4%	328.8	3.7%	(3.7%)
Customer Deposits	237.2	252.5	6.4%	244.3	3.0%	(3.4%)
Total Liabilities	261.6	278.6	6.5%	271.1	3.6%	(2.9%)
Shareholders' Funds	50.1	59.3	18.4%	60.2	20.0%	1.6%

Balance sheet ratios	H1'19	H1'20	% y/y change
Loan to Deposit Ratio	72.6%	73.1%	0.5%
Return on average equity	17.7%	15.4%	(2.3%)
Return on average assets	2.9%	2.7%	(0.2%)

Income Statement	H1'2019 Kshs bn	H1'2020 Kshs bn	y/y change	H1'2020 e	Expected y/y change	Variance in Actual Growth vs. Expected
Net Interest Income	7.0	6.9	(1.4%)	7.7	10.2%	11.6%
Net non-Interest Income	4.5	4.2	(7.1%)	3.5	(22.9%)	(15.8%)
Total Operating income	11.6	11.1	(3.6%)	11.2	(2.8%)	0.8%
Loan Loss provision	(1.1)	(1.0)	(7.0%)	(1.4)	30.3%	37.4%
Total Operating expenses	(5.7)	(6.1)	5.5%	(6.4)	11.8%	6.3%
Profit before tax	6.2	4.5	(27.7%)	5.9	(5.0%)	22.7%
Profit after tax	4.5	3.2	(29.5%)	4.1	(8.6%)	20.9%
Core EPS	5.5	3.9	(29.5%)	5.0	(8.6%)	20.9%

Income statement ratios	H1'2019	H1'2020	% y/y change
Yield from interest-earning assets	10.4%	9.8%	(0.6%)
Cost of funding	4.7%	4.6%	(0.0%)
Net Interest Margin	6.0%	5.5%	(0.6%)
Net Interest Income as % of operating income	60.7%	62.2%	1.4%
Non-Funded Income as a % of operating income	39.3%	37.8%	(1.4%)
Cost to Income Ratio	49.7%	58.1%	8.5%
CIR without LLP	40.1%	48.2%	8.2%
Cost to Assets	1.5%	1.5%	0.0%

Capital Adequacy Ratios	Q1'19	Q1'20
Core Capital/Total Liabilities	19.8%	19.9%
Minimum Statutory ratio	8.0%	8.0%
Excess	11.8%	11.9%
Core Capital/Total Risk-Weighted Assets	16.1%	16.3%
Minimum Statutory ratio	10.5%	10.5%
Excess	5.6%	5.8%
Total Capital/Total Risk-Weighted Assets	18.4%	21.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	3.9%	6.9%
Liquidity Ratio	48.8%	47.0%
Minimum Statutory ratio	20.0%	20.0%
Excess	28.8%	27.0%
Adjusted Core Capital/Total Liabilities	20.1%	20.0%

Adjusted Core Capital/Total RWA	16.3%	16.4%
Adjusted Total Capital/Total RWA	18.6%	21.5%