

Below is a summary of the I&M Holdings Q1'2021 performance;

Balance Sheet Items	Q1'2020	Q1'2021	y/y change
Government Securities	54.1	102.4	89.5%
Net Loans and Advances	182.9	193.2	5.6%
Total Assets	336.0	364.4	8.5%
Customer Deposits	240.7	263.1	9.3%
Total Liabilities	273.3	294.9	7.9%
Shareholders' Funds	59.3	65.6	10.5%

Balance Sheet Ratios	Q1'2020	Q1'2021	% point change
Loan to Deposit Ratio	76.0%	73.4%	(2.6%)
Return on average equity	17.5%	13.3%	(4.2%)
Return on average assets	3.0%	2.4%	(0.6%)

Income Statement	Q1'2020	Q1'2021	y/y change
Net Interest Income	3.5	4.3	23.4%
Net non-Interest Income	2.2	1.8	(17.7%)
Total Operating income	5.7	6.1	7.4%
Loan Loss provision	(0.6)	(0.8)	36.7%
Total Operating expenses	(3.0)	(3.6)	18.0%
Profit before tax	2.5	2.7	7.0%
Profit after tax	1.7	1.9	13.5%
Core EPS	2.0	2.3	13.5%

Income Statement Ratios	Q1'2020	Q1'2021	% point change
Yield from interest-earning assets	10.1%	9.4%	(0.7%)
Cost of funding	4.7%	4.4%	(0.3%)
Net Interest Margin	5.8%	5.4%	(0.4%)
Net Interest Income as % of operating income	61.2%	70.3%	9.1%
Non-Funded Income as a % of operating income	38.8%	29.7%	(9.1%)
Cost to Income Ratio	52.9%	58.0%	5.1%
CIR without LLP	43.1%	45.7%	2.6%
Cost to Assets	0.7%	0.8%	0.1%

Capital Adequacy Ratios	Q1'2020	Q1'2021
Core Capital/Total Liabilities	21.8%	22.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	13.8%	14.3%
Core Capital/Total Risk Weighted Assets	16.8%	18.1%
Minimum Statutory ratio	10.5%	10.5%
Excess	6.3%	7.6%
Total Capital/Total Risk Weighted Assets	21.1%	21.6%
Minimum Statutory ratio	14.5%	14.5%
Excess	6.6%	7.1%
Liquidity Ratio	48.3%	47.1%

Minimum Statutory ratio	20.0%	20.0%
Excess	28.3%	27.1%
<i>Adjusted Core Capital/Total Liabilities</i>	<i>21.9%</i>	<i>22.3%</i>
<i>Adjusted Core Capital/Total RWA</i>	<i>16.9%</i>	<i>18.1%</i>
<i>Adjusted Total Capital/Total RWA</i>	<i>21.2%</i>	<i>21.7%</i>

Key Highlights Q1'2021

- I&M Holdings will receive a Tier 2 subordinated loan of USD 50.0 mn (Kshs 5.4 bn) long-term loan from the International Finance Corporation (IFC) to boost it's capital and enhance its lending capacity of SMEs. The loan will have a maturity of up to 7 years with a grace period of 5 years, conforming with the Central Bank of Kenya's Tier 2 capital requirements.

Income Statement

- Core earnings per share increased by 13.5% to Kshs 2.3, from Kshs 2.0 in Q1'2020, not in line with our expectations. The growth in core earnings per share was driven by a 23.4% increase in Net Interest Income to Kshs 4.3 bn, from Kshs 3.5 in Q1'2020,
- Total operating income increased by 7.4% to Kshs 6.1 bn, from Kshs 5.7 bn in Q1'2020, driven by a 23.4% increase in Net Interest Income (NII) to Kshs 4.3 bn, from Kshs 3.5 bn in Q1'2020. The increase in NII was however weighed down by a 17.7% decline in Non-Funded Income (NFI) to Kshs 1.8 bn, from Kshs 2.2 bn in Q1'2020,
- Interest income rose by 10.2% to Kshs 7.1 bn, from Kshs 6.5 bn in Q1'2020. This was driven by a 104.9% growth in interest income from government securities to Kshs 2.1 bn, from Kshs 1.0 bn in Q1'2020. The growth in interest income was however weighed down by a 68.8% decline in interest income from placements to Kshs 46.2 mn, from Kshs 147.9 mn in Q1'2020, coupled with a 4.7% decline in interest income from loans and advances to Kshs 5.1 bn, from Kshs 5.3 bn in Q1'2020. The Yield on Interest-Earning Assets declined to 9.4% from 10.1% in Q1'2020, largely attributable to the 11.1% growth in average interest earning assets which grew faster than the 3.6% growth in trailing Interest Income. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense declined by 5.2% to Kshs 2.8 bn, from Kshs 3.0 bn in Q1'2020, following a 9.6% decline in Interest expense on deposits to Kshs 2.4 bn, from Kshs 2.6 bn in Q1'2020. The decline in interest expense was however weighed down by a 46.1% growth in the interest expense on placements to Kshs 248.9 mn, from Kshs 170.3 mn in Q1'2020. Cost of funds declined by 0.3% points to 4.4% from 4.7% recorded in Q1'2020, following a 9.7% increase in average interest bearing liabilities, which outpaced the 2.1% increase in trailing interest expense. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) on the other hand, declined by 0.4% points to 5.5%, from 5.8% in Q1'2020, despite the 23.4% increase in NII and the 11.1% increase in average interest-earning assets,
- Non-Funded Income decreased by 17.7% to Kshs 1.8 bn, from Kshs 2.2 bn in Q1'2020, driven by a 40.6% decline in foreign exchange trading income to Kshs 0.3 bn, from Kshs 0.6 bn in Q1'2020, coupled with a 12.3% decline in fees and commissions from loans and advances to Kshs 0.4 bn, from Kshs 0.5 bn in Q1'2020. Notably, income from Total Fees and Commissions decreased by 5.3% to Kshs 1.06 bn, from Kshs 1.12 bn recorded in Q1'2020 attributable to the waiver on bank fees which expired on 2nd March 2021. The revenue mix shifted to 70:30 funded to non-funded income, from 61:39, owing to the 23.4% increase in NII, compared to the 17.7% decline in NFI,
- Total operating expenses rose by 18.0% to Kshs 3.6 bn from Kshs 3.0 bn in Q1'2020, largely driven by a 36.7% increase in Loan Loss Provisions (LLP) to Kshs 0.8 bn, from Kshs 0.6 bn in Q1'2020, on account of the poor operating environment brought about by COVID-19 which has adversely affected individuals and businesses'

ability to repay loans. Staff costs on the other hand, remained relatively unchanged at Kshs 1.2 bn during the period,

- Cost to Income Ratio (CIR) deteriorated to 58.0%, from 52.9% in Q1'2020 attributable to the 36.7% increase in Loan Loss Provisions to Kshs 0.8 bn, from Kshs 0.6 bn in Q1'2020. Without LLP, cost to income ratio deteriorated as well to 45.7%, from 43.1% in Q1'2020, an indication of reduced efficiency, and,
- Profit before tax increased by 7.0% to Kshs 2.7 bn, from Kshs 2.5 bn in Q1'2020. Profit after tax rose by 13.5% to Kshs 1.9 bn, from Kshs 1.7 bn in Q1'2020, with the effective tax rate decreasing to 29.1%, from 33.1% in Q1'2020.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 8.5% to Kshs 364.4 bn, from Kshs 336.0 bn in Q1'2020. The growth was supported by an 89.5% increase in government securities to Kshs 102.4 bn, from Kshs 54.1 bn in Q1'2020, coupled with a 5.6% loan book expansion to Kshs 193.2 bn, from Kshs 182.9 bn in Q1'2020. The increased allocation to government securities seen during the period was partly attributable to the elevated credit risk associated with lending to customers following the adverse effects of the ongoing pandemic on the operating environment,
- Total liabilities rose by 7.9% to Kshs 294.9 bn, from Kshs 273.3 bn in Q1'2020, driven by a 9.3% rise in customer deposits to Kshs 263.1 bn, from Kshs 240.7 bn in Q1'2020. The growth was however mitigated by a 22.3% decline in placements liabilities to Kshs 10.2 bn, from Kshs 13.2 bn in Q1'2020. Deposits per branch increased by 11.0% to Kshs 4.0 bn from Kshs 3.6 bn in Q1'2020, with the number of branches declining to 66 from 67 branches in Q1'2020,
- The slower 5.6% growth in loans as compared to the 9.3% growth in deposits led to a decline in the loan to deposit ratio to 73.4% from 76.0% in Q1'2020,
- Gross non-performing loans increased by 11.3% to Kshs 24.7 bn in Q1'2021, from Kshs 22.2 bn in Q1'2020. Consequently, the NPL ratio, rose to 11.9% in Q1'2021, from 11.3% in Q1'2020, attributable to the faster 11.3% increase in Gross Non-Performing Loans, which outpaced the 6.3% growth in gross loans. The NPL coverage on the other hand improved to 61.1% in Q1'2021, from 58.8% in Q1'2020, as general Loan Loss Provisions increased by 24.4% to Kshs 11.2 bn from Kshs 9.0 bn in Q1'2020,
- Shareholders' funds increased by 10.5% to Kshs 65.6 bn in Q1'2021, from Kshs 59.3 bn in Q1'2020, supported by a 16.4% increase in retained earnings to Kshs 40.5 bn, from Kshs 34.8 bn in Q1'2020,
- I&M Holdings Plc remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 18.1%, 7.6% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 21.6%, exceeding the statutory requirement by 7.1% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 18.1%, while total capital to risk-weighted assets came in at 21.7%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.4%, and a Return on Average Equity (ROaE) of 13.3%.

Key Take-Outs:

1. Profit before tax increased by 7.0% to Kshs 2.7 bn, from Kshs 2.5 bn in Q1'2020 while profit after tax rose by 13.5% to Kshs 1.9 bn, from Kshs 1.7 bn in Q1'2020. The increase in profitability is attributable to the improving operating environment during the period,
2. Due to the weakened business environment on account of the COVID-19 pandemic, the bank took a proactive stance in its provisioning levels as Loan Loss Provisions (LLP) increased by 36.7% to Kshs 0.8 bn in Q1'2021, from Kshs 0.6 bn in Q1'2020,
3. The bank's asset quality deteriorated, with the NPL ratio increasing to 11.9%, from 11.3% in Q1'2020. NPL coverage improved to 61.1% in Q1'2021 from 58.8% in Q1'2020, as general Loan Loss Provisions increased by 24.4% to Kshs 11.2 bn from Kshs 9.0 bn in Q1'2020, with gross non-performing loans increasing by 11.3%,
4. Non-Funded Income decreased by 17.7% to Kshs 1.8 bn, from Kshs 2.2 bn in Q1'2020, driven by a 40.6% decline in foreign exchange trading income to Kshs 0.3 bn, from Kshs 0.6 bn in Q1'2020, coupled with a 12.3%

decline in fees and commissions from loans and advances to Kshs 0.4 bn from Kshs 0.5 bn in Q1'2020. Income from other fees and commissions declined marginally by 0.2% to Kshs 647.5 mn from Kshs 649.1 in Q1'2020 while other income decreased by 18.5% to Kshs 0.4 bn from Kshs 0.5 bn in Q1'2020,

5. There was a decline in efficiency levels as the Cost to Income Ratio (CIR) deteriorated to 58.0%, from 52.9% in Q1'2020, attributable to the 36.7% increase in Loan Loss Provisions to Kshs 0.8 bn from Kshs 0.6 bn in Q1'2020. Without LLP, cost to income ratio deteriorated as well to 45.7% from 43.1% in Q1'2020,, an indication of reduced efficiency.

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

- I. Geographical Diversification – The bank has been aggressively expanding into other regions, namely Tanzania, Rwanda, and Uganda. On this front, the bank has completed the acquisition of 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.

Valuation Summary

- We are of the view that I&M Holdings Plc is a “**Buy**” with a target price of Kshs 29.9 representing an upside of 38.7%, from the current price of Kshs 21.6 as of 28th May, 2021, inclusive of a dividend yield of 11.6%,
- I&M Holdings Plc is currently trading at a P/TBV of 0.6x and a P/E of 4.3x vs an industry average of 0.7x and 6.1x, respectively.