

Valuation Summary

- We are of the view that I&M Holdings Plc is a “**BUY**” with a target price of Kshs 63.6, representing an upside of 38.2%, from the current price of Kshs 46.0 as of 4th December 2020, inclusive of a dividend yield of 5.5%,
- I&M Holdings Plc is currently trading at a P/TBV of 0.7x and a P/E of 4.5x vs an industry average of 0.7x and 9.8x, respectively.

Key Highlights Q3'2020

- I&M Holdings plc issued a circular to its shareholders on 3rd November 2020 revealing it will pay Kshs 3.6 bn to acquire 90.0% of the share capital of Orient Bank Limited Uganda (OBL). The amount will be subject to adjustments on account of several factors including exchange rate fluctuations and amounts raised from the sale of the Ugandan bank's property in Kampala (Orient Plaza). The shares will be bought from Hemlata Karia, Jay Karia, Morka Holdings Limited, Zhong Shuang Quan, Cornerstone M8 Limited and the bank's Vice Chairman and founder, Dr Ketan Morjaria. Dr Morjaria, who currently holds a 7.9% stake in Orient Bank, is only selling a 2.4% stake to remain with a 5.5% stake in what will be I&M's Ugandan subsidiary. The announcement comes 4 months after the two banks started negotiations, in July, which was covered in our [Cyttonn Weekly #30/2020](#).

Income Statement

- Core earnings per share declined by 30.8% to Kshs 5.5, from Kshs 8.0 in Q3'2019, not in line with our projections of a 21.9% decline to Kshs 6.3. The performance was driven by an 18.4% increase in total operating expenses to Kshs 9.7 bn from Kshs 8.2 bn in Q3'2019, coupled with a 0.7% decline in total operating income to Kshs 16.8 bn from Kshs 16.9 in Q3'2019. The variance in core earnings per share decline to Kshs 5.5 against our expectation of Kshs 6.3 was largely due to the 65.4% increase in Loan Loss Provisions (LLP) to Kshs 2.1 bn, from Kshs 1.3 bn in Q3'2019, higher than our 26.4% projected increase,
- Total operating income declined by 0.7% to Kshs 16.8 bn, from Kshs 16.9 bn in Q3'2019. This was driven by a 1.7% decline in Net Interest Income (NII) to Kshs 10.4 bn, from Kshs 10.6 bn in Q3'2019. The decline was however mitigated by a 1.1% increase in Non-Funded Income (NFI) to Kshs 6.4 bn, from Kshs 6.3 bn in Q3'2019,
- Interest income rose by 3.0% to Kshs 19.7 bn, from Kshs 19.2 bn in Q3'2019. This was driven by a 16.9% growth in interest income from government securities to Kshs 3.7 bn, from Kshs 3.1 bn in Q3'2019, coupled with a 1.8% increase in interest income from Loans and Advances to 15.8 bn, from 15.5 bn in Q3'2019. The growth in interest income was weighed down by a 45.3% decline in placements income to Kshs 260.0 mn from Kshs 475.5 mn in Q3'2019. The yield on interest-earning assets declined to 9.6% from 10.3% in Q3'2019, largely attributable to a faster 8.9% increase in average interest earning assets as compared to the 1.7% growth in trailing Interest Income,
- Interest expense rose by 8.9% to Kshs 9.3 bn, from Kshs 8.6 bn in Q3'2019, following a 6.0% rise in Interest expense on deposits to Kshs 8.2 bn from Kshs 7.8 bn in Q3'2019, coupled with a 214.5% growth in the interest expense on placements to Kshs 0.5 bn, from Kshs 0.2 bn in Q3'2019. Cost of funds increased marginally, by 0.04% points to 4.65% from 4.61% recorded in Q3'2019, following a 9.1% increase in trailing interest expense, which outpaced the 8.2% increase in average interest bearing liabilities. Net Interest Margin (NIM) on the other hand, declined to 5.3%, from 6.0% in Q3'2019 due to the 1.7% decline in NII, despite the 8.9% increase in average interest-earning assets,
- Non-Funded Income increased by 1.1% to Kshs 6.4 bn, from Kshs 6.3 bn in Q3'2019, driven by a 3.4% increase in income from fees and commissions on loans and advances to Kshs 1.43 bn from Kshs 1.38 bn in Q3'2019. The increase was however weighed down by a 28.7% decline in Foreign Exchange Trading income to Kshs 1.4 bn from Kshs 1.9 bn in Q3'2019 coupled with a 12.8% decline in other fees and commissions income to Kshs 1.6 bn from Kshs 1.9 bn in Q3'2019, attributed to the waiver on banking fees. Notably, total fees and commissions declined

by 5.9% to Kshs 3.0 bn from Kshs 3.2 bn recorded in Q3’2019. The revenue mix shifted to 62:38 funded to non-funded income, from 63:37, owing to the 1.7% decline in NII, compared to the 1.1% increase in NFI,

- Total operating expenses rose by 18.4% to Kshs 9.7 bn from Kshs 8.2 bn in Q3’2019, largely driven by a 65.4% increase in Loan Loss Provisions (LLP) to Kshs 2.1 bn, from Kshs 1.3 bn in Q3’2019, coupled with a 20.6% growth in other operating expenses to Kshs 4.1 bn from Kshs 3.4 bn in Q3’2019. Staff costs on the other hand, declined marginally by 0.2% to Kshs 3.51 bn in Q3’2020, from Kshs 3.52 bn in Q3’2019,
- Cost to Income Ratio (CIR), with LLP deteriorated to 57.9%, from 48.6% in Q3’2019. Without LLP, cost to income ratio deteriorated as well to 45.1% from 40.9% in Q3’2019, an indication of reduced efficiency, and,
- Profit before tax declined by 30.2% to Kshs 6.5 bn, down from Kshs 9.3 bn in Q3’2019. Profit after tax declined by 30.8% to Kshs 4.6 bn in Q3’2020 from Kshs 6.6 bn in Q3’2019, with the effective tax rate increasing to 29.4%, from 28.7% in Q3’2019.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 6.3% to Kshs 344.7 bn, from Kshs 324.3 bn in Q3’2019. The growth was supported by a 70.9% increase in government securities to Kshs 91.4 bn, from Kshs 53.5 bn in Q3’2019, coupled with a 6.7% loan book expansion to Kshs 185.7 bn from Kshs 174.1 bn in Q3’2019. Placements on the other hand declined by 59.2% to Kshs 21.2 bn from Kshs 52.0 bn in Q3’2019,
- Total liabilities rose by 5.3% to Kshs 280.8 bn, from Kshs 266.7 bn in Q3’2019, driven by a 7.0% rise in customer deposits to Kshs 252.8 bn from Kshs 236.2 bn in Q3’2019. The growth was however weighed down by a 12.7% decline in placements to Kshs 9.4 bn, from Kshs 10.8 bn in Q3’2019. Deposits per branch increased by 17.7% to Kshs 3.6 bn from Kshs 3.1 bn in Q3’2019, with the number of branches decreasing from 77 to 70 during the period,
- The slower 6.7% growth in loans as compared to the 7.0% growth in deposits led to a decline in the loan to deposit ratio to 73.4% from 73.7% in Q3’2019,
- Gross non-performing loans declined by 6.2% to Kshs 22.6 bn in Q3’2020 from Kshs 24.1 bn in Q3’2019. Consequently, the NPL ratio, improved to 11.2% in Q3’2020, from 12.7% in Q3’2019, attributable to the faster 6.1% growth in gross loans, which outpaced the 6.2% decline in Gross Non-Performing Loans. The NPL coverage on the other hand improved to 66.8% in Q3’2020 from 62.5% in Q3’2019, as general Loan Loss Provisions increased by 27.6% to Kshs 10.5 bn from Kshs 8.3 bn in Q3’2019, which was despite a 6.2% decline in gross non-performing loans,
- Shareholders’ funds increased by 10.9% to Kshs 60.5 bn in Q3’2020, from Kshs 54.5 bn in Q3’2019, supported by an 8.8% increase in retained earnings to Kshs 34.5 bn, from Kshs 31.7 bn in Q3’2019,
- I&M Holdings Plc remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.5%, 6.0% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 21.3%, exceeding the statutory requirement by 6.8% 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 21.4%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.4%, and a Return on Average Equity (ROaE) of 14.5%.

Key Take-Outs:

1. Due to the weakened business environment on account of the COVID-19 pandemic, the bank took a conservative stance in its provisioning levels as Loan Loss Provisions (LLP) increased by 65.4% to Kshs 2.1 bn in Q3’2020, from Kshs 1.3 bn in Q3’2019,
2. The bank’s asset quality improved, with the NPL ratio improving to 11.2%, from 12.7% in Q3’2019. NPL coverage also improved to 66.8% in Q3’2020 from 62.5% in Q3’2019, as general Loan Loss Provisions increased by 27.6% to Kshs 10.5 bn from Kshs 8.3 bn in Q3’2019, despite a 6.2% decline in gross non-performing loans,
3. NFI increased by 1.1% to 6.4 bn from 6.3 bn, mainly attributable to a 3.4% increase in fees and commissions on loans and advances while NII declined by 1.7% to Kshs 10.4 bn from 10.6 bn in Q3’2019,

4. There was a decline in efficiency levels as the cost to income ratio without LLP worsened to 45.1% from 40.9% in Q3'2019, 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 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 Items | Q3'2019 | Q3' 2020 | y/y change | Q3'2020e | Expected y/y change | Variance in Growth Actual vs. Expected |
|----------------------------|--------------|--------------|--------------|--------------|---------------------|--|
| Government Securities | 53.5 | 91.4 | 70.9% | 73.8 | 38.1% | (32.8%) |
| Net Loans and Advances | 174.1 | 185.7 | 6.7% | 180.5 | 3.7% | (3.0%) |
| Total Assets | 324.3 | 344.7 | 6.3% | 344.0 | 6.1% | (0.2%) |
| Customer Deposits | 236.2 | 252.8 | 7.0% | 256.3 | 8.5% | 1.5% |
| Total Liabilities | 266.7 | 280.8 | 5.3% | 284.1 | 6.5% | 1.2% |
| Shareholders' Funds | 54.5 | 60.5 | 10.9% | 57.5 | 5.5% | (5.4%) |

| Balance Sheet Ratios | Q3'2019 | Q3' 2020 | % y/y change |
|--------------------------|---------|----------|--------------|
| Loan to Deposit Ratio | 73.7% | 73.4% | (0.3%) |
| Return on average equity | 17.2% | 14.5% | (2.6%) |
| Return on average assets | 2.8% | 2.4% | (0.4%) |

| Income Statement | Q3'2019 | Q3' 2020 | y/y change | Q3'2020e | Expected y/y change | Variance in Growth Actual vs. Expected |
|-------------------------------|-------------|-------------|----------------|-------------|---------------------|--|
| Net Interest Income | 10.6 | 10.4 | (1.7%) | 10.6 | 0.2% | 1.9% |
| Net non-Interest Income | 6.3 | 6.4 | 1.1% | 5.8 | (8.2%) | (9.3%) |
| Total Operating income | 16.9 | 16.8 | (0.7%) | 16.4 | (3.0%) | (2.3%) |
| Loan Loss provision | (1.3) | (2.1) | 65.4% | (1.6) | 26.4% | (39.0%) |
| Total Operating expenses | (8.2) | (9.7) | 18.4% | (8.4) | 2.7% | (15.7%) |
| Profit before tax | 9.3 | 6.5 | (30.2%) | 7.4 | (20.5%) | 9.7% |
| Profit after tax | 6.6 | 4.6 | (30.8%) | 5.2 | (21.9%) | 8.9% |
| Core EPS | 8.0 | 5.5 | (30.8%) | 6.3 | (21.9%) | 8.9% |

| Income Statement Ratios | Q3'2019 | Q3' 2020 | y/y change |
|--|---------|----------|------------|
| Yield from interest-earning assets | 10.3% | 9.6% | (0.7%) |
| Cost of funding | 4.61% | 4.65% | 0.04% |
| Net Interest Margin | 6.0% | 5.3% | (0.7%) |
| Net Interest Income as % of operating income | 62.5% | 61.9% | (0.7%) |
| Non-Funded Income as a % of operating income | 37.5% | 38.1% | 0.7% |
| Cost to Income Ratio | 48.6% | 57.9% | 9.3% |

| | | | |
|-----------------|-------|-------|------|
| CIR without LLP | 40.9% | 45.1% | 4.2% |
| Cost to Assets | 2.1% | 2.2% | 0.1% |

| Capital Adequacy Ratios | Q3'2019 | Q3' 2020 |
|--|--------------|--------------|
| Core Capital/Total Liabilities | 20.0% | 20.2% |
| Minimum Statutory ratio | 8.0% | 8.0% |
| Excess | 12.0% | 12.2% |
| Core Capital/Total Risk Weighted Assets | 15.9% | 16.5% |
| Minimum Statutory ratio | 10.5% | 10.5% |
| Excess | 5.4% | 6.0% |
| Total Capital/Total Risk Weighted Assets | 19.4% | 21.3% |
| Minimum Statutory ratio | 14.5% | 14.5% |
| Excess | 4.9% | 6.8% |
| Liquidity Ratio | 48.7% | 47.2% |
| Minimum Statutory ratio | 20.0% | 20.0% |
| Excess | 28.7% | 27.2% |
| Adjusted Core Capital/Total Liabilities | 20.2% | 20.3% |
| Adjusted Core Capital/Total RWA | 16.0% | 16.6% |
| Adjusted Total Capital/Total RWA | 19.5% | 21.4% |