I&M Holdings Plc – Q3'2021
3rd December, 2021

Below is a summary of the I&M Holdings Q3'2021 performance;

Balance Sheet Items	Q3'2020	Q3'2021	y/y change
Government Securities	91.4	117.5	28.6%
Net Loans and Advances	185.7	207.6	11.8%
Total Assets	**344.7**	**399.1**	**15.8%**
Customer Deposits	252.8	288.7	14.2%
Total Liabilities	**280.8**	**326.9**	**16.4%**
Shareholders' Funds	**60.5**	**68.0**	**12.5%**

Balance Sheet Ratios	Q3'2020	Q3'2021	% y/y change
Loan to Deposit Ratio	73.4%	71.9%	(1.5%)
Return on average equity	14.5%	14.3%	(0.2%)
Return on average assets	2.5%	2.5%	0.0%

Income Statement	Q3'2020	Q3'2021	y/y change
Net Interest Income	10.4	14.0	34.5%
Net non-Interest Income	6.4	6.2	(3.5%)
Total Operating income	**16.8**	**20.2**	**20.0%**
Loan Loss provision	(2.1)	(2.8)	31.4%
Total Operating expenses	(9.7)	(12.5)	28.7%
Profit before tax	6.5	8.1	24.6%
Profit after tax	**4.6**	**5.7**	**25.1%**
Core EPS	**2.8**	**3.5**	**25.1%**

Income Statement Ratios	Q3'2020	Q3'2021	y/y change
Yield from interest-earning assets	9.6%	9.8%	0.2%
Cost of funding	4.6%	4.0%	(0.6%)
Net Interest Margin	5.3%	6.0%	0.7%
Net Interest Income as % of operating income	61.9%	69.3%	7.4%
Non-Funded Income as a % of operating income	38.1%	30.7%	(7.4%)
Cost to Income Ratio	57.9%	62.1%	4.2%
CIR without LLP	45.1%	48.1%	3.0%
Cost to Assets	2.2%	2.4%	0.2%

Capital Adequacy Ratios	Q3'2020	Q3'2021
Core Capital/Total Liabilities	20.2%	20.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**12.2%**	**12.3%**
Core Capital/Total Risk Weighted Assets	16.5%	15.9%
Minimum Statutory ratio	10.5%	10.5%
Excess	**6.0%**	**5.4%**
Total Capital/Total Risk Weighted Assets	21.3%	20.7%
Minimum Statutory ratio	14.5%	14.5%
Excess	**6.8%**	**6.2%**
Liquidity Ratio	47.2%	49.4%
Minimum Statutory ratio	20.0%	20.0%
Excess	**27.2%**	**29.4%**
Adjusted Core Capital/Total Liabilities	**20.3%**	**20.4%**
Adjusted Core Capital/Total RWA	**16.6%**	**16.0%**
Adjusted Total Capital/Total RWA	**21.4%**	**20.7%**

Key Highlights Q3'2021

- I&M Group PLC announced the rebranding of Uganda's Orient Bank Limited (OBL) to I&M Bank (Uganda) Limited following the launch of the bank's operations in Uganda. The rebrand comes six months after I&M Holding PLC announced the completion of the 90.0% acquisition of Orient Bank Limited Uganda (OBL) on 30th April 2021 and after receiving all the required regulatory approvals. As highlighted in our Cytonn Weekly #18/2021, I&M Holdings was to take over 14 branches from Orient Bank Limited Uganda (OBL), taking its total branches to 89, from 66 branches as at the end of 2020. For more information, see our Cytonn Weekly #45/2021.

Income Statement

- Core earnings per share increased by 25.1% to Kshs 3.5, from Kshs 2.8 in Q3'2020, not in line with our expectations of a 48.5% increase to Kshs 6.8. The increase was mainly driven by a 20.0% increase in Total Operating Income to Kshs 20.2 bn, from Kshs 16.8 bn in Q3'2020, with the performance being weighed down by 28.7% increase in Total Operating Expenses to Kshs 12.5 bn, from Kshs 9.7 bn recorded in Q3'2020. The variance in our projections can be attributed to the 31.4% increase in Loan Loss Provisions (LLP), against our expectation of a 2.3% decline,
- Total operating income increased by 20.0% to Kshs 20.2 bn, from Kshs 16.8 bn in Q3'2020, driven by a 34.5% increase in Net Interest Income (NII) to Kshs 14.0 bn, from Kshs 10.4 bn in Q3'2020. The increase in NII was however weighed down by a 3.5% decline in Non-Funded Income (NFI) to Kshs 6.2 bn, from Kshs 6.4 bn in Q3'2020,
- Interest income rose by 15.7% to Kshs 22.8 bn, from Kshs 19.7 bn in Q3'2020 driven by a 76.2% growth in interest income from government securities to Kshs 6.5 bn, from Kshs 3.7 bn in Q3'2020 coupled with a 2.5% increase in interest income from loans and advances to Kshs 16.2 bn, from Kshs 15.8 bn in Q3'2020. The growth in interest income was however weighed down by a 34.0% decline in interest income from placements to Kshs 0.2 bn, from Kshs 0.3 bn in Q3'2020. The Yield on Interest-Earning Assets (YIEA) increased to 9.8%, from 9.6% in Q3'2020, largely attributable to the 11.6% growth in trailing Interest Income, which grew faster than the 9.8% growth in average interest earning assets. 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 8.9 bn, from Kshs 9.3 bn in Q3'2020, following an 8.8% decline in Interest expense on deposits to Kshs 7.5 bn, from Kshs 8.2 bn in Q3'2020. The decline in interest expense was however weighed down by a 32.8% growth in the interest expense on placements to Kshs 0.7 bn, from Kshs 0.5 bn in Q3'2020. Cost of funds declined by 0.6% points to 4.0%, from 4.6% recorded in Q3'2020, following a 5.2% decline in trailing interest expense, coupled with a 10.9% increase in average interest bearing liabilities. 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, rose by 0.7% points to 6.0%, from 5.3% in Q3'2020, attributable to the 25.2% increase in trailing NII, which outpaced the 9.8% increase in average interest-earning assets,
- Non-Funded Income declined by 3.5% to Kshs 6.2 bn, from Kshs 6.4 bn in Q3'2020, driven by a 13.7% decline in foreign exchange trading income to Kshs 1.2 bn, from Kshs 1.4 bn in Q3'2020, coupled with a 21.3% decline in other income to Kshs 1.6 bn, from Kshs 2.0 bn in Q3'2020. Fees and commissions on loans and advances also declined by 3.8% to Kshs 1.37 bn, from Kshs 1.43 bn in Q3'2020. Notably, income from Total Fees and Commissions increased by 12.8% to Kshs 3.4 bn, from Kshs 3.0 bn recorded in Q3'2020, driven by a 27.4% increase in other fees and commissions, attributable to the expiry of the waiver on fees and commissions issued by the CBK in march 2020. The revenue mix shifted to 69:31 funded to non-funded income, from 62:38, owing to the 34.5% increase in NII, compared to the 3.5% decline in NFI,
- Total operating expenses rose by 28.7% to Kshs 12.5 bn, from Kshs 9.7 bn in Q3'2020, driven by a 31.4% increase in Loan Loss Provisions (LLP) to Kshs 2.8 bn, from Kshs 2.1 bn in Q3'2020 coupled with a 22.9% increase in staff costs to Kshs 4.3 bn, from Kshs 3.5 bn in Q3'2020. The increase in the group's LLP is on account of the lender catering for the Manufacturing, Trade, Real Estate and Personal/Household sectors which remain adversely impacted by the COVID-19 pandemic and jointly constitute 79.0% of the group's loan portfolio,

- Cost to Income Ratio (CIR) deteriorated to 62.1%, from 57.9% in Q3’2020, driven by the 31.4% increase in LLP to Kshs 2.8 bn, from Kshs 2.1 bn in Q3’2020, coupled with a 22.9% increase in staff costs to Kshs 4.3 bn in Q3’2021, from Kshs 3.5 bn in Q3’2020. Without LLP, cost to income ratio deteriorated as well to 48.1%, from 45.1% in Q3’2020, an indication of reduced efficiency, and,
- Profit before tax increased by 24.6% to Kshs 8.1 bn, from Kshs 6.5 bn in Q3’2020. Profit after tax rose by 25.1% to Kshs 5.7 bn, from Kshs 4.6 bn in Q3’2020, with the effective tax rate decreasing to 29.1%, from 29.4% in Q3’2020.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 15.8% to Kshs 399.1 bn, from Kshs 344.7 bn in Q3’2020. The growth was supported by a 28.6% increase in government securities to Kshs 117.5 bn, from Kshs 91.4 bn in Q3’2020, coupled with an 11.8% loan book expansion to Kshs 207.6 bn, from Kshs 185.7 bn in Q3’2020. The increased allocation to government securities seen during the period was partly attributable to the elevated credit risk associated with lending to customers,
- Total liabilities rose by 16.4% to Kshs 326.9 bn, from Kshs 280.8 bn in Q3’2020, driven by an 73.3% increase in borrowings to Kshs 20.3 bn, from Kshs 11.7 bn in Q3’2020, with the increase in borrowings mainly attributable to a USD 50.0 mn (Kshs 5.6 bn) and USD 10.0 mn (Kshs 1.1 bn) loan from The International Finance Corporation (IFC) to I&M Bank Kenya and I&M Bank Rwanda, respectively, to expand lending to MSMEs in the region in addition to serving as an additional capital buffer for the group. Additionally, customer deposits rose by 14.2% to Kshs 288.7 bn, from Kshs 252.8 bn in Q3’2020. Deposits per branch decreased by 10.2% to Kshs 3.2 bn from Kshs 3.6 bn in Q3’2020, with the number of branches increasing to 89 from 70 branches in Q3’2020,
- The faster 14.2% growth in customer deposits as compared to the 11.8% growth in loans and advances led to a decline in the loan to deposit ratio to 71.9%, from 73.4% in Q3’2020,
- Gross non-performing loans increased by 0.7% to Kshs 22.7 bn in Q3’2021, from Kshs 22.6 bn in Q3’2020. The banks’ asset quality improved, with the NPL ratio declining to 10.2% in Q3’2021, from 11.2% in Q3’2020, attributable to the faster 11.4% increase in Gross Loans, which outpaced the 0.7% growth in gross Non-Performing loans. Key to note, the lender’s NPL ratio of 10.2% is the lowest it has been since Q3’2017, signifying the sustained improvement in the group’s loan book performance. The NPL coverage also improved to 70.6% in Q3’2021, from 66.8% in Q3’2020, as general Loan Loss Provisions increased by 14.8% to Kshs 12.1 bn, from Kshs 10.5 bn in Q3’2020,
- Shareholders’ funds increased by 12.5% to Kshs 68.0 bn in Q3’2021, from Kshs 60.5 bn in Q3’2020, supported by a 23.2% increase in retained earnings to Kshs 42.5 bn, from Kshs 34.5 bn in Q3’2020,
- I&M Holdings Plc remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.9%, 5.4% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 20.7%, exceeding the statutory requirement by 6.2% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 16.0%, while total capital to risk-weighted assets came in at 20.7%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.5%, and a Return on Average Equity (ROaE) of 14.3%.

Key Take-Outs:

1. On account of the bank’s exposure to the the Manufacturing, Trade, Real Estate and Personal/Household sectors which remain adversely impacted by the COVID-19 pandemic and jointly constitute 79.0% of the group’s loan portfolio, the bank took a proactive stance in its provisioning levels as Loan Loss Provisions (LLP) increased by 31.4% to Kshs 2.8 bn in Q3’2021, from Kshs 2.1 bn in Q3’2020,
2. The bank’s asset quality improved, with the NPL ratio declining to 10.2%, from 11.2% in Q3’2020, which is the lowest it has been since Q3’2017. The NPL coverage improved to 70.6% in Q3’2021, from 66.8% in Q3’2020, as general Loan Loss Provisions increased by 14.8% to Kshs 12.1 bn, from Kshs 10.5 bn in Q3’2020, with gross non-performing loans increasing by 0.7%. Cost of risk, however, recorded an increase, rising to 14.0%, from 12.8% in

Q3'2020 attributable to the 31.4% increase in Loan Loss Provisions, which grew faster than the 20.0% increase in Total Operating Income,

3. Non-Funded Income decreased by 3.5% to Kshs 6.2 bn, from Kshs 6.4 bn in Q3'2020, driven by a 21.3% decline in other income to Kshs 1.6 bn, from Kshs 2.0 bn in Q3'2020, coupled with a 13.7% decline in foreign exchange trading income to Kshs 1.2 bn, from Kshs 1.4 bn in Q3'2020. Fees and commissions on loans and advances also recorded a decline, decreasing by 3.8% to Kshs 1.37 bn, from Kshs 1.43 bn in Q3'2020, and,
4. There was a decline in efficiency levels as the Cost to Income Ratio (CIR) deteriorated to 62.1%, from 57.9% in Q3'2020, driven by the 31.4% increase in LLP to Kshs 2.8 bn, from Kshs 2.1 bn in Q3'2020, coupled with a 22.9% increase in staff costs to Kshs 4.3 bn in Q3'2021, from Kshs 3.5 bn in Q3'2020. Without LLP, cost to income ratio deteriorated as well to 48.1%, from 45.1% in Q3'2020, an indication of reduced efficiency. Key to note, I&M's Cost to Income ratio is at an all time high, indicating the group's reduced efficiency. I&M should consider reducing operating expenses such as staff costs, which recorded a 22.9% y/y growth, in order to prevent further deterioration of efficiency going forward.

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

I. Revenue Diversification – The bank launched its Wealth Management and Advisory Business, which will be provided through I&M Capital, a subsidiary of I&M Group PLC targeting high net worth and premium customers. The move to offer wealth management and advisory services, is expected to boost the bank's Non-Funded Income revenue through fees and commissions charged and reduce I&M's reliance on funded income, and,

II. Geographical Diversification – The entry of I&M Group PLC into the Ugandan Market will see the bank diversify its operations thus further reduce its reliance on the Kenyan Market. The launch also will also see I&M cement its position as a regional bank, with Uganda becoming the 4th country I&M operates in the East African region with the rest being Kenya, Tanzania and Rwanda. We believe that Uganda will continue to attract more Kenyan banks given its attractive lending interest rate spread which stood at 17.0% in June 2021, higher than Tanzania's 13.8% and Kenya's 12.1% over the same period.

Valuation Summary

- We are of the view that I&M Holdings Plc is a "***Buy***" with a target price of Kshs 31.7, representing an upside of 53.8%, from the current price of Kshs 20.6 as of 3rd December, 2021, inclusive of a dividend yield of 6.6%, and,
- I&M Holdings Plc is currently trading at a P/TBV of 0.5x and a P/E of 3.7x vs an industry average of 0.7x and 4.8x, respectively.