Kenya Listed Commercial Banks Review
Cytonn Q3'2019 Banking Sector Report

"Higher Net Interest Margins and Consolidation to Drive Growth in the Post Rate Cap Era"

Cytonn

Sunday, 08th December 2019

I. Introduction to Cytonn

About Us

Cytonn Investments is an alternative investment manager, with real estate development capability, and a primary focus on private equity and real estate investments in the high growth Kenyan Region. Cytonn has a unique strategy of coupling two compelling demand areas - the lack of high yielding investment products and the lack of institutional grade real estate. We provide high yielding investment instruments to attract funding from investors, and we deploy that funding to largely pre-sold investment grade real estate. With offices in Kenya and Washington, DC - USA, we are primarily focused on offering alternative investment solutions to global and local institutional investors, individual high net-worth investors, and diaspora investors interested in the East-African region. Real estate investments are made through our development affiliate, Cytonn Real Estate, where we currently have over Kshs. 82 billion (USD 820 mn) of projects under mandate across ten projects. In private equity, we invest in banking, education, and hospitality.

82 Over Kshs. 82 billion worth of projects under mandate

7 Seven offices across 2 continents

500 Over 500 staff members, including Cytonn Distribution

10 10 investment ready projects in real estate

A unique franchise differentiated by:

Independence & Investor Focus

Focused on serving the interest of clients, which is best done on an independent platform to minimize conflicts of interest

Alternative Investments

Specialized focus on alternative assets - Real Estate, Private Equity, and Structured Solutions

Strong Alignment

Every staff member is an owner in the firm. When clients do well, the firm does well; and when the firm does well, staff do well

Committed Partners

Strong global and local partnerships in financing, land and Cytonn Real Estate, our development affiliate

Why We Exist

Africa presents an attractive investment opportunity for investors seeking attractive and long-term returns. Despite the alternative markets in Africa having high and stable returns, only a few institutional players serve the market. Cytonn is focused on delivering higher returns in the alternative markets, while providing the best client service and always protecting our clients' interests.

WE SERVE THREE MAIN CLIENT SEGMENTS:

- High Net-worth Individuals through Cytonn Private Wealth. This is done through our captive Distribution Network
- East Africans in the Diaspora through Cytonn Diaspora
- Global and Local Institutional Clients. These clients are served from our Investment & Fundraising Team

WE INVEST OUR CLIENT FUNDS IN:

- Real Estate, and Real Estate Related Businesses
- Private Equity
- Fixed Income Structured Solutions
- Equities Structured Solutions

Our Business Structure

Cytonn Investments Management Plc

- **Cytonn Capital Partners** (Private Markets)
  - Private Offers and Real Estate Investments
  - Cytonn Hospitality
  - Cytonn Education Services
  - Superior Homes Kenya
  - Procurement
- **Cytonn Asset Managers** (Regulated by CMA & RBA)
  - Unit Trust Funds
  - Cytonn Africa Financial Fund
  - Cytonn Advisory
  - Pension Fund Management
- **Cytonn Real Estate**
  - Research and Deal Origination
  - Project Management
  - Quality Assurance/ Control
  - Cytonn Procurement - Cymatt
  - Cytonn Real Estate Legal
  - Cytonn Properties
  - Cytonn Centre for Affordable Housing
- **Other Strategic Initiatives**
  - Cytonn Distribution
  - East African Forum for Alternative Investments

II. Kenya Economic Review and Outlook

Kenya Macro-Economic Review

Of the 7 indicators we track, 3 are positive, 3 are neutral and 1 is negative. We maintain our positive outlook on the 2019 macroeconomic environment

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicators	**YTD 2019 Experience and Outlook Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
GDP Growth	• In Q2'2019, the country's economic activity experienced relatively slower growth, expanding by 5.6%, similar to the 5.6% recorded in Q1'2019 but slower compared to the 6.4% growth recorded in Q2'2018 • In 2019, GDP growth is projected to range between 5.7%-5.9%, lower than the 6.3% growth in 2018, but higher than the 5-year historical average of 5.4%, driven by; i. Growth in the agriculture sector, ii. Implementation of the Big 4 Agenda projects by the Kenyan Government and, iii. Relatively stable business environment evidenced by the Stanbic Bank Monthly Purchasing Manager's Index (PMI), which remained unchanged at 53.2 in November 2019 similar to what was recorded in October, an indication of improving business conditions	**Positive**	**Positive**
Inflation	• The average inflation rate increased to an average of 5.1% in Q3'2019, as compared to 4.4% in Q3'2018, the hike attributable to higher food prices and rising transportation costs during the quarter • We expect inflation to remain within the government target range of 2.5% - 7.5%, with inflationary pressures expected to emanate from the effects of the rise in electricity tariffs and fuel prices	**Positive**	**Positive**

Kenya Macro-Economic Review (cont..)

Of the 7 indicators we track, 3 are positive, 3 are neutral and 1 is negative. We maintain our positive outlook on the 2019 macroeconomic environment

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicators	**YTD 2019 Experience and Outlook Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
Government Borrowing	• We are negative on domestic borrowing, due to the levels of domestic debt maturities in FY'2019/20 currently at Kshs 119.5bn, coupled with the historical underperformance of ordinary revenues, with the Government being 5.9% behind its target • Despite the underperformance, the Government raised its total revenue target by 14.2% to Kshs 2.1 tn for FY'2019/20 which we doubt it will meet, thus exert slight pressure on the domestic borrowing front to plug in the deficit • The repeal of the interest rate cap is also likely to make it difficult for the government to access domestic debt	**Neutral**	**Negative**
Exchange Rate	• We expect the Kenyan Shilling to remain relatively stable against the dollar, supported by; i. CBK's activities in the money market, such as repurchase agreements and selling of dollars, ii. High levels of forex reserves, currently at USD 9.0 bn (equivalent to 5.6-months of import cover) iii. Improving diaspora remittances, which have increased cumulatively by 8.0% in the 12-months to September 2019 to USD 2.8 bn, from USD 2.6 bn recorded in a similar period of review in 2018	**Neutral**	**Neutral**

Kenya Macro-Economic Review (cont..)

Of the 7 indicators we track, 3 are positive, 3 are neutral and 1 is negative. We maintain our positive outlook on the 2019 macroeconomic environment

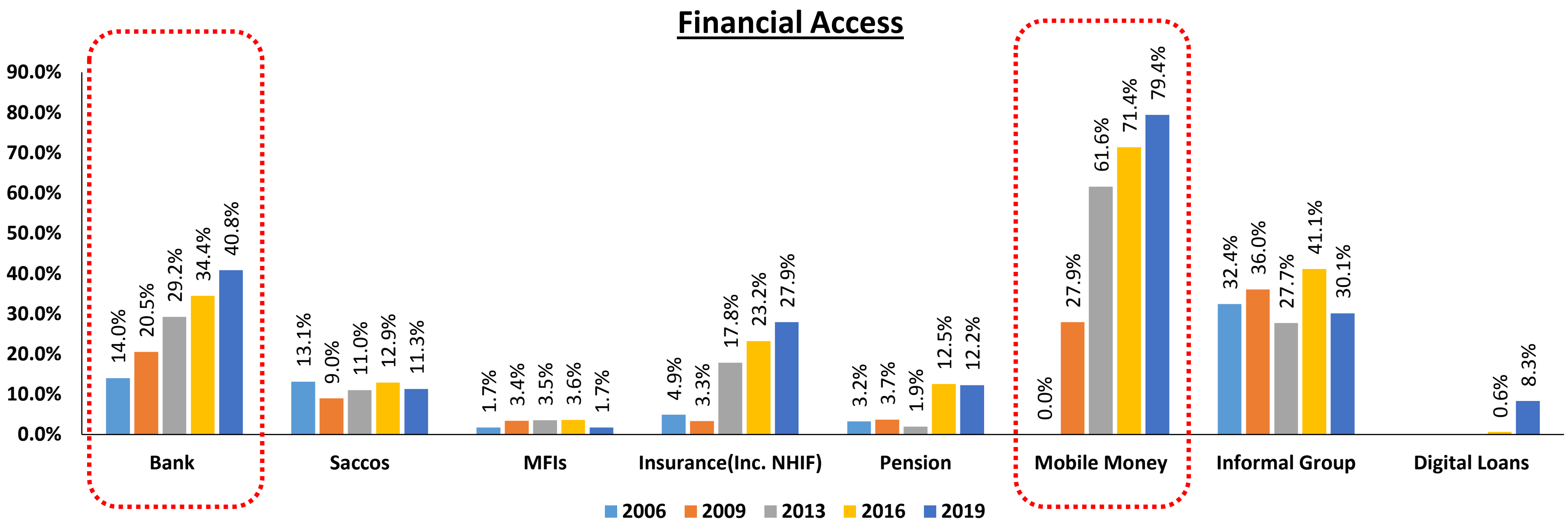
Macro-Economic & Business Environment Outlook			
Macro-Economic Indicators	**YTD 2019 Experience and Outlook Going Forward**	**Outlook - Beginning of Year**	**Current Outlook**
Interest Rates	• The interest rate environment has remained stable in 2019, with the CBR having been retained at 9.0% in the 2 MPC meetings held in Q3'2019, however, in the November MPC meeting, the CBR was lowered to 8.5% as a measure to stimulate GDP growth • With the heavy domestic maturities in 2019, we expect slight upward pressure on interest rates going forward, as the government tries to meet its domestic borrowing targets for the 2019/2020 fiscal year • With a repeal in the interest rate cap, we expect an improvement in private sector credit growth and increased competition for bank funds, which will in turn lead to tightened liquidity in the money market and an upward pressure on interest rates	**Neutral**	**Neutral**
Investor Sentiment	• The May 2019 Kenya Eurobond issue was 4.5x oversubscribed partly showing the appetite for Kenyan securities by the foreign community, and investor confidence in Kenya's stable and relatively diversified economy • We expect improved foreign inflows from the negative position in 2018, mainly supported by long-term investors who enter the market looking to take advantage of the current cheap valuations in select sections of the market	**Neutral**	**Neutral**
Security	• The political climate in the country has eased. Despite the recent terror attack experienced during the first half of 2019, Kenya was spared from travel advisories, evidence of the international community's confidence in the country's security position	**Positive**	**Positive**

III. Banking Sector Overview

Kenya Banking Sector Overview

Financial Inclusion in Kenya continues to rise, mainly driven by proliferation of mobile and digital channels

- In Kenya there are a total of 39 commercial banks, 1 mortgage finance company, 13 microfinance banks, 9 representative offices of foreign banks, 73 foreign exchange bureaus, 19 money remittance providers and 3 credit reference bureaus
- Financial inclusion in Kenya has continued to rise, with 82.9% of the adult population able to access formal financial services. This has largely been driven by digitization, with Mobile Financial Services (MFS), transfer and lending, rising to be the preferred method to access financial services in 2019, with 79.4% of the adult population using the channel



Source: Central Bank of Kenya, FinAccess report

Recent Developments in the Kenyan Banking Sector

The Finance Act 2019 was passed, scrapping off interest rate caps

1. Regulation:

i. **Finance Act 2019 -** During the period under review, the Finance Act 2019 was passed, which effectively repealed section 33B of the Banking Act, which had previously capped interest rates at a maximum of 4.0% points above the Central Bank Rate (CBR). The removal of interest rate caps is expected to enhance access to credit by the private sector. Banks' performance are expected to improve as they are able price risk better without a rate cap,

ii. **Removal of Interest Rate Floors -** Following the removal of interest rate floors in 2018, that required banks to pay lenders at least 70% of the base lending rate, deposit rates hit a 36-month low in September 2019, to stand at 4.6% compared to 6.3% in September 2018 as lenders continue to ride on cheaper deposits.

iii. **IFRS 9 -** With the implementation of IFRS 9, which took effect from 1st January 2018, banks were expected to provide both for the incurred and expected credit losses. The CBK had given commercial banks a one year earnings protection window for the implementation of the IFRS 9 to charge the higher provisions against the retained earnings in the balance sheet and not on the profit and loss account. The banking industry is bracing for its full effects in 2019, expecting reduced profitability and an eroded capital base as a result of increased provisioning,

Recent Developments in the Kenyan Banking Sector

Consolidation continues in the banking sector, with the most recent being that of NIC and CBA to form NCBA

2. Consolidation: Kenya's banking sector has witnessed heightened M&A activity over the last 4 years. In Q3'2019, KCB Group completed the acquisition of National Bank of Kenya, while CBA group merged with NIC to form the third largest bank by assets in Kenya. The Competition Authority of Kenya and the Central Bank of Kenya has also given a go ahead for Access bank to acquire a 93.57% stake in Transnational bank and more recently, Egypt's Commercial International Bank is seeking approval to acquire a controlling stake in Mayfair Bank. Below is a summary of key transactions done over the last five years and their transaction multiples

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs bns)	Transaction Stake	Transaction Value (Kshs bns)	P/Bv Multiple	Date
CBA Group	NIC Group	33.5	53:47	23.0	**0.7x**	Sept-2019
Oiko Credit	Credit Bank	3	22.8%	1	**1.5x**	Aug-2019
KCB Group	National Bank of Kenya	7	100.0%	6.6	**0.9x**	Apr-2019
CBA Group	Jamii Bora Bank	3.4	100.0%	1.4	**0.4x**	Jan-2019
AfricInvest Azure	Prime Bank	21.2	24.2%	5.1	**1.0x**	Jan-2019
KCB Group	Imperial Bank	Unknown	Undisclosed	Undisclosed	**N/A**	Dec-2018
SBM Bank Kenya	Chase Bank ltd	Unknown	75.0%	Undisclosed	**N/A**	Aug-2018
DTBK	Habib Bank Kenya	2.4	100.0%	1.8	**0.8x**	Mar-2017
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	**1.6x**	Nov-2017
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	**1.4x**	Jun-2016
I&M Holdings	Giro Commercial Bank	3	100.0%	5	**1.7x**	Jun-2016
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	**2.3x**	Mar-2015
Centum	K-Rep Bank	2.1	66.0%	2.5	**1.8x**	Jul-2014
GT Bank	Fina Bank Group	3.9	70.0%	8.6	**3.2x**	Nov-2013
Average			**73.7%**		**1.4x**	

Recent Developments in the Kenyan Banking Sector

CBK and various banks launched their SME-focussed lending programs, with the launch of the Stawi facility being the key highlight

3. SME-Focussed Lending:

i. The Central Bank of Kenya (CBK) launched a loan facility dubbed as 'Stawi' targeting Micro Small and Medium Enterprises (MSMEs), enabling businesses to access unsecured loans ranging from Kshs 30,000 to Kshs 250,000 from five commercial banks (NIC Group, KCB Group, Diamond Trust Bank Kenya (DTBK), Co-operative Bank Kenya and Commercial Bank of Africa (CBA)), with a repayment period of between 1 – 12 months. Priced at 9.0% p.a, the credit product will help address MSMEs challenges such as access to formal credit because of the informal nature of their businesses and lack of collateral, amid low private sector credit growth rate,

ii. Credit Bank acquired a Kshs 824.0 mn loan from Africa Development Bank for onward lending to SMEs. The loan is to be accessed by companies in the construction, agriculture, renewable energy and manufacturing sector, in a bid to enhance sustainable growth.

iii. The African Guarantee Fund (AGF) set aside USD 170.0 mn (Kshs 17.1 bn) with an aim to back Kenyan Banks to enable them to lend to MSMEs. AGF committed to guarantee half the value of a loan balance to a single MSME borrower or half the value of an outstanding MSME loan portfolio, charging banks a fee ranging between 1.5%- 3.0% for the risk guarantee, and

iv. Additionally, Equity Bank Kenya acquired a syndicated loan worth Kshs 10.0 bn from the International Finance Corporation (IFC) in order to extend loans to MSMEs and climate friendly investors, in a bid to deepen financial inclusion and boost sustainable investments in Kenya

Banking Sector Growth Drivers

Alternative channels of transactions, revenue diversification and regional expansion remain the key growth drivers for banks

1. **Increased Adoption of Technology -** Banks have been riding on the digital revolution wave to improve their operational efficiency. Increased adoption of alternative channels of transactions such as mobile, internet and agency banking, has led to increased transactions carried out via alternative channels and out of bank branches, which have been reduced to handling high value transactions and other services such as advisory. Thus banks reduced front-office operations, thereby cutting the number of staff required and by extension, reducing operating expenses and hence, improving operational efficiency,

2. **Revenue Diversification -** Banks have continued to diversify their revenue sources, in a bid to increase profit margins. Banks increased the fees and commissions on loans, and ventured into various NFI growth ventures such as banc assurance, brokerage services, and fleet management. NFI was also earned from transactional income obtained as the number of transactions increased buoyed by increased adoption of alternative channels of transactions,

3. **Regional Expansion -** Kenyan banks continued to pursue their inorganic growth strategies beyond Kenya, as they seek to increase their profit margins and compete better with a key example being Equity Group Holdings, who announced being in talks to acquire a majority stake (66.5%) in Banque Commercial du Congo (BCDC, subject to shareholder and regulatory approvals) in a deal that will see them pay Kshs 10.7 bn. The bank's plan is to enter new markets through a combination of acquisitions and setting up of fresh operations such as in Ethiopia,

Banking Sector Growth Drivers

Refocus on core operation, expansion and further consolidation are among the key growth drivers for banks

4. **Refocus on Core Operations -** With the option of pricing loans as per risk profiles of borrowers, banks will be able to increase interest rates with bias to credit risk rating of borrowers, which will in turn improve their interest income. This was already witnessed in Q2’2019 and Q3’2019 where banks have increased SME lending which in turn increased loan growth. This can be expected to persist post the interest rate cap era,

5. **Expansion and Further Consolidation-** With the Microfinance-Bill 2019 of increasing the minimum on core capital requirements still in its pilot stage more mergers and acquisitions would enable the unprofitable and/or smaller banks to manage the requirement and be able to increase profitability through cost efficiency and deposits growth.

Consolidation and Revenue Diversification to Drive Growth

Focus Area	Summary	Effect on Banking Sector
Regulation	• **Finance Act 2019:** The act was passed which effectively repealed Section 33B of the Banking Act that previously capped interest rate caps at a maximum of 4.0% above the Central Bank Rate	• Increased lending because banks are able to price risk better without a rate cap • Net Interest Margins expected to shift upwards as banks can now set their own interest rates • Overall performance of the sector will improve owing to better net interest margins
Diversification	• **Revenue Diversification:** Banks continued their focus on diversifying their revenue sources, targeting transactional fee income, as well as increased income from non-banking subsidiaries	• Consistent relatively strong profitability growth, which has alleviated the effects of a relatively slow funded income growth
Consolidation	• **Increase in Mergers & Acquisitions:** With increased competition amongst players in the banking sector, coupled with tough operating environment, has led to several consolidation activity has happened.	• Consolidation in the sector have resulted in (i) aiding in successful remediation of collapsed banks, (ii) leaving fewer but well capitalized players able to catalyze economic growth, thus creating a more stable banking sector
Asset Quality	• **High Non-Performing Loans:** the Gross NPL ratio stood at 9.8%, unchanged from Q3'2018 much higher than the 5-year average of 8.2%. This raises concerns around asset quality in the sector	• The increased NPLs and adoption of IFRS 9 has forced banks to adopt a more stringent risk assessment framework, to effectively reduce financial impairments and consequently the provisioning requirements required under the new reporting standard, leading to reduced credit extension

The Banking sector maintained its growth trajectory largely aided by recovery in funded income as well as a relatively stronger growth in NFI. Increased usage of alternative channels improves operational efficiency as well as expanding Non-Funded Income. Deteriorating asset quality remains a concern, which has seen banks reduce lending to the riskier private sector and instead continue channeling funds to government securities

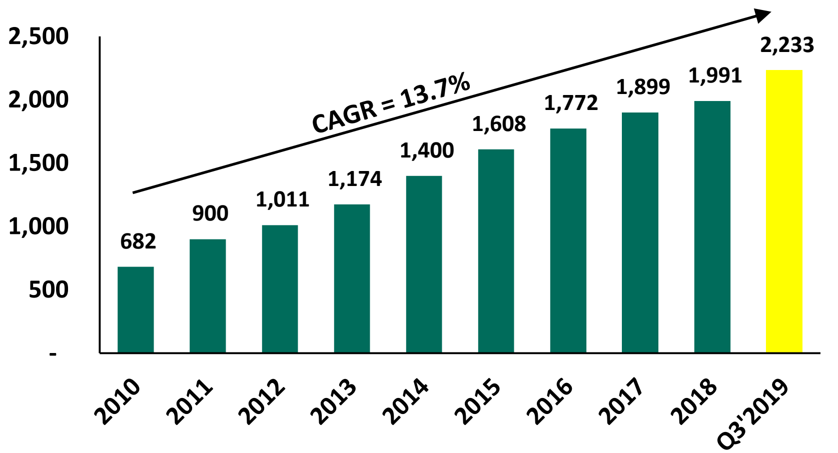
III. Listed Banking Sector Metrics

Cytonn

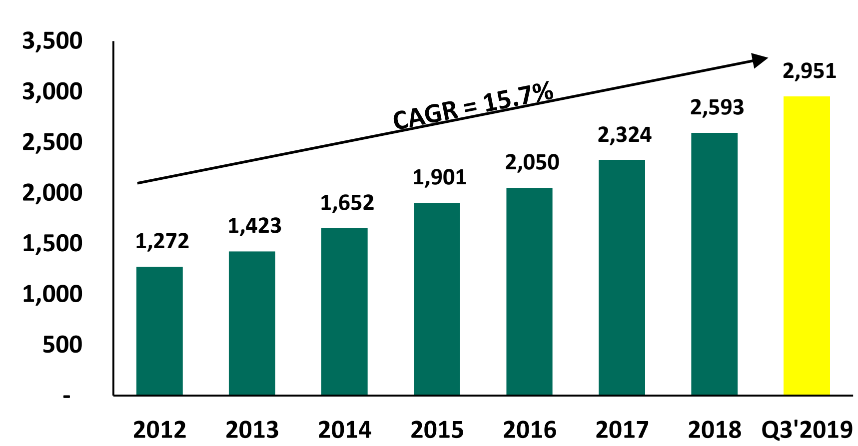
Listed Banking Sector Metrics

Deposit growth has remained strong, faster than the growth in loans and advances

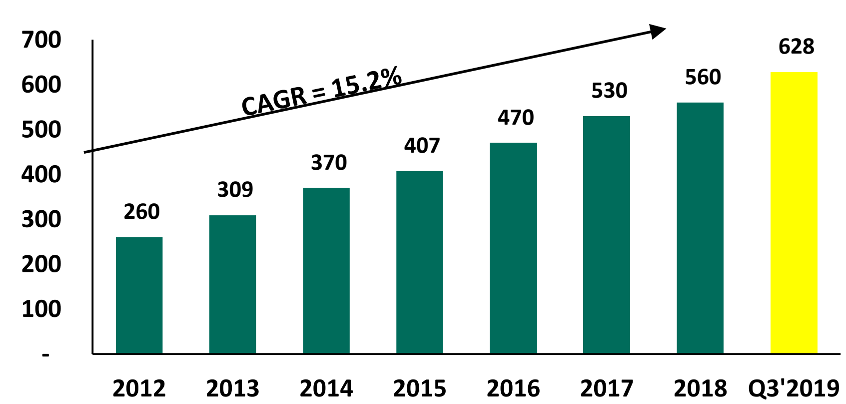
Loans and Advances (Kshs Bn)



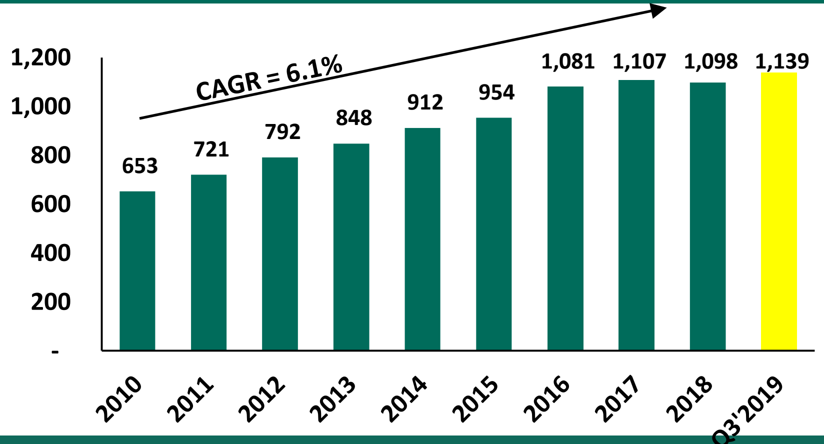
Deposits (Kshs Bn)



Shareholders Equity (Kshs Bn)



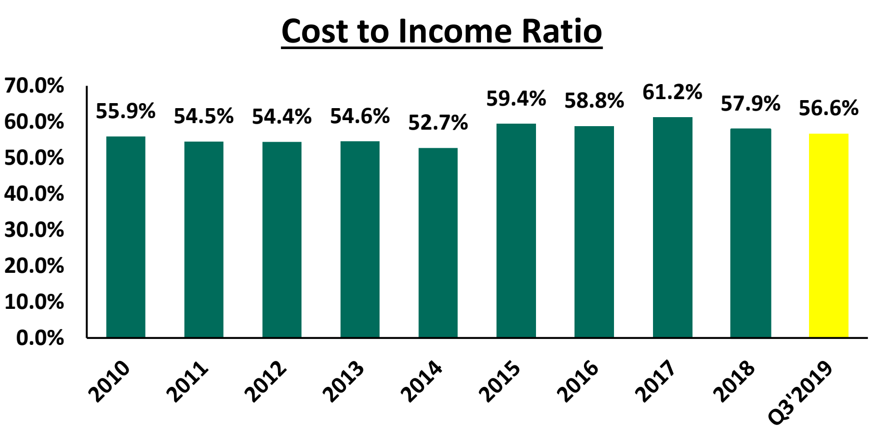
Bank Branches



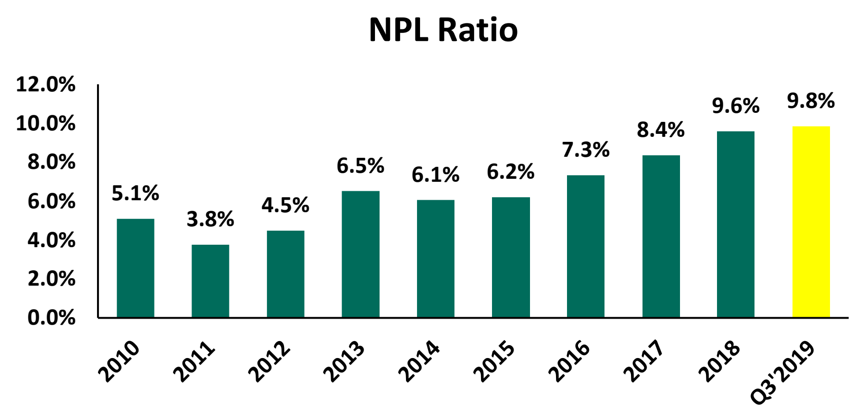
Listed Banking Sector Metrics

With the repeal of the rate capping law, lending is expected to improve, with banks continuing to focus on improving efficiency, growing NFI and containing asset quality deterioration

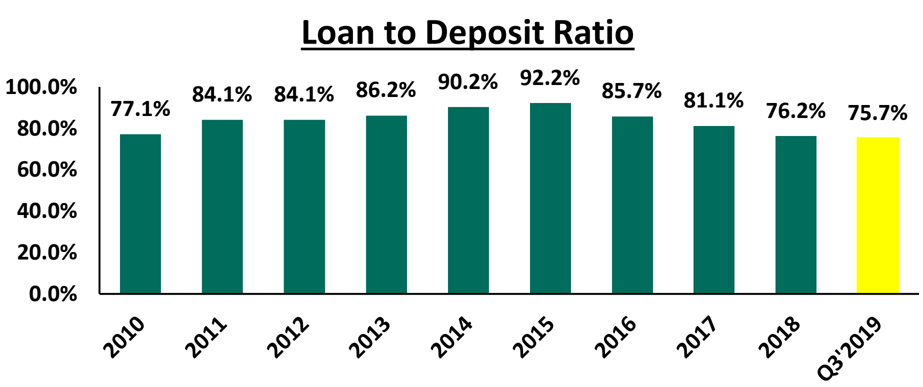
Cost to Income Ratio



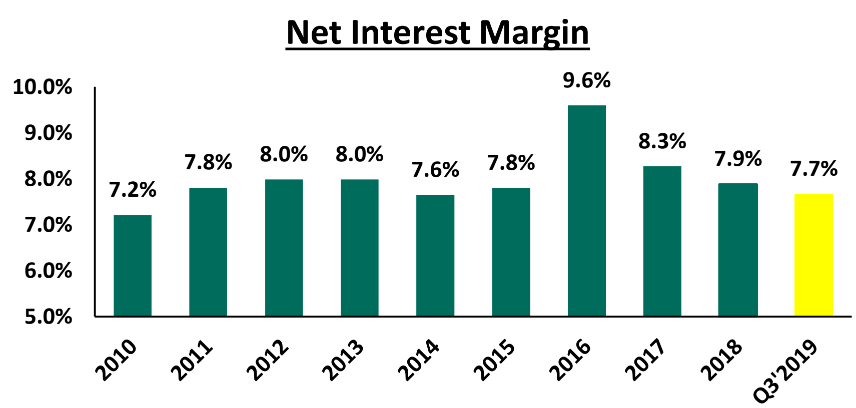
NPL Ratio



Loan to Deposit Ratio



Net Interest Margin



Listed Banking Earnings and Growth Metrics

Kenya's listed banking sector Q3'2019 core EPS increased by 8.7%, slower compared to a growth of 16.2% in Q3'2018

Bank	Core EPS Growth	Net Interest Margin	NFI to Total Operating Income	Deposit Growth	Growth In Govt Securities	Loan Growth	LDR	Cost to Income	Return on Average Equity
HF Group	74.5%**	4.5%	38.4%	(0.1%)	(7.0%)	(13.7%)	113.3%*	102.9%	(3.3%)
Barclays Bank	19.0%	8.5%	32.1%	6.9%	3.0%	8.8%	82.5%	63.3%	17.4%
NCBA Group	16.3%	5.3%	47.2%	10.7%	7.4%	8.2%	66.8%	62.0%	14.9%
I&M Holdings	13.4%	6.0%	37.5%	13.0%	(0.7%)	6.6%	73.7%	48.6%	17.2%
Equity Bank	10.4%	8.4%	41.1%	18.9%	7.8%	21.0%	73.0%	54.8%	21.7%
DTBK	7.5%	5.6%	24.1%	0.3%	(1.2%)	(2.9%)	67.8%	52.2%	14.6%
KCB Group	6.2%	8.2%	35.2%	11.4%	7.5%	11.7%	82.9%	54.4%	22.2%
Coop Bank	5.5%	8.1%	40.0%	8.9%	13.6%	5.8%	83.4%	56.2%	18.4%
SCBK	(1.3%)	7.5%	32.2%	2.4%	(7.9%)	6.8%	52.7%	57.7%	16.9%
Stanbic Bank	N/A ****	6.9%	47.7%	5.4%	(33.2%)	14.6%	84.6%	63.5%	18.5%
Q3'2019 Weighted Average* **	**8.7%**	**7.7%**	**38.0%**	**11.0%**	**3.3%**	**11.6%**	**75.7%**	**56.6%**	**19.3%**
Q3'2018 Weighted Average	**16.2%**	**8.0%**	**34.5%**	**7.4%**	**17.8%**	**4.2%**	**75.3%**	**56.5%**	**18.8%**

**Loans to Loanable funds used owing to nature of the business*

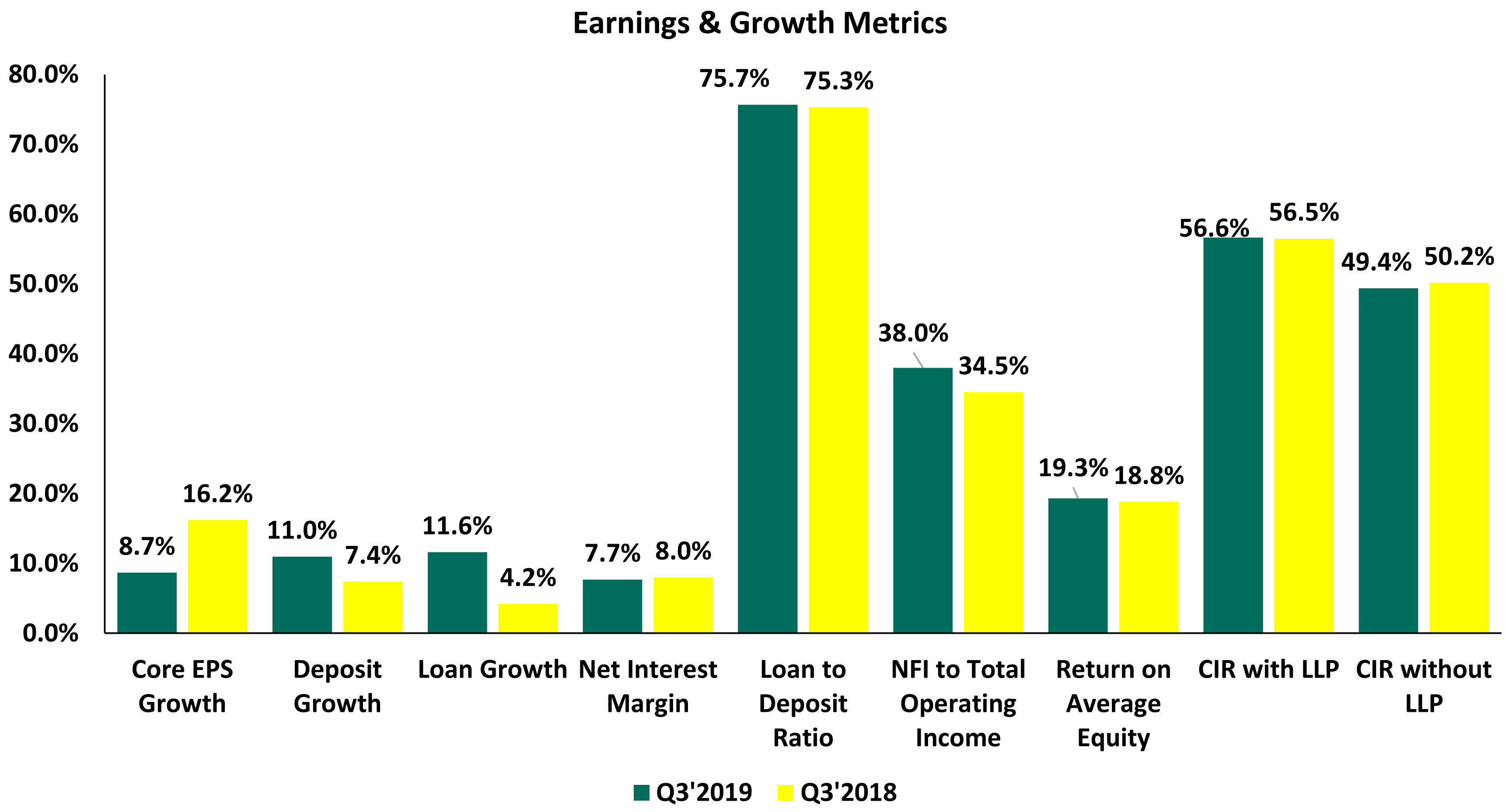
*** HF Group had the highest EPS growth but this was a reduction in loss per share as they are not profitable yet*

****The weighted average is based on market capitalization as at 29th Nov 2019*

***** Core EPS growth unavailable since the bank trades as Stanbic Holdings but only released results for Stanbic Bank*

Listed Banks Earnings and Growth Metrics Cont…

Listed banks witnessed an improvement in operational efficiency, an improvement in total operating income, and consequently higher NFI to Total Operating Income ratio



Listed Banks Operating Metrics

Non Funded Income currently contributes 38.0% of banks' total operating income, up from 34.5% in Q3'2018, owing to the recovery in NFI after implementation of EIR in 2018

Bank	Deposit/Branch (bn)	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non Funded Income/Revenue
Stanbic Bank	7.4	10.9%	58.9%	12.6%	47.7%
NCBA Group	4.5	12.4%	60.2%	13.6%	47.2%
Equity Bank	1.6	8.4%	45.8%	15.0%	41.1%
Coop Bank	2.1	10.5%	55.5%	16.2%	40.0%
HF Group	1.6	28.2%	44.4%	16.9%	38.4%
I&M Holdings	5.6	12.3%	62.5%	15.5%	37.5%
KCB Group	2.3	8.3%	56.5%	15.3%	35.2%
SCBK	6.6	14.9%	77.0%	15.8%	32.2%
Barclays Bank	2.7	6.8%	78.6%	12.0%	32.1%
DTBK	2.2	8.9%	48.0%	15.1%	24.1%
Weighted Average Q3'2019*	**3.1**	**9.8%**	**57.8%**	**14.8%**	**38.0%**
Weighted Average Q3'2018	**2.9**	**9.9%**	**54.2%**	**14.8%**	**34.5%**

**Market cap weighted average as at 29th November 2019*

Listed Banks Trading Metrics

The listed banking sector has continued to trade at cheaper prices, as it is currently trading at an average P/TBv of 1.4x and average P/E of 7.3x

Bank	No. of Shares (bn)	Market Cap (Kshs bn)	P/E	Price per Share* (Kshs)	P/TBV
HF Group	0.4	2.3	4.0x	6.0	0.2x
NCBA Group	1.5	52.3	5.2x	35.0	0.8x
DTBK	0.3	32.2	4.3x	115.0	0.6x
Coop Bank	5.9	94.2	7.1x	16.1	1.3x
I&M Holdings	0.8	40.5	4.6x	49.0	0.8x
KCB Group	3.2	160.7	6.4x	50.0	1.4x
Stanbic Bank	0.4	44.3	6.8x	112.0	1.2x
Barclays Bank	5.4	67.6	9.0x	12.5	1.6x
SCBK	0.3	66.4	8.3x	193.3	1.5x
Equity Bank	3.8	192.5	9.0x	51.0	1.9x
Weighted Average Q3'2019			**7.3x**		**1.4x**

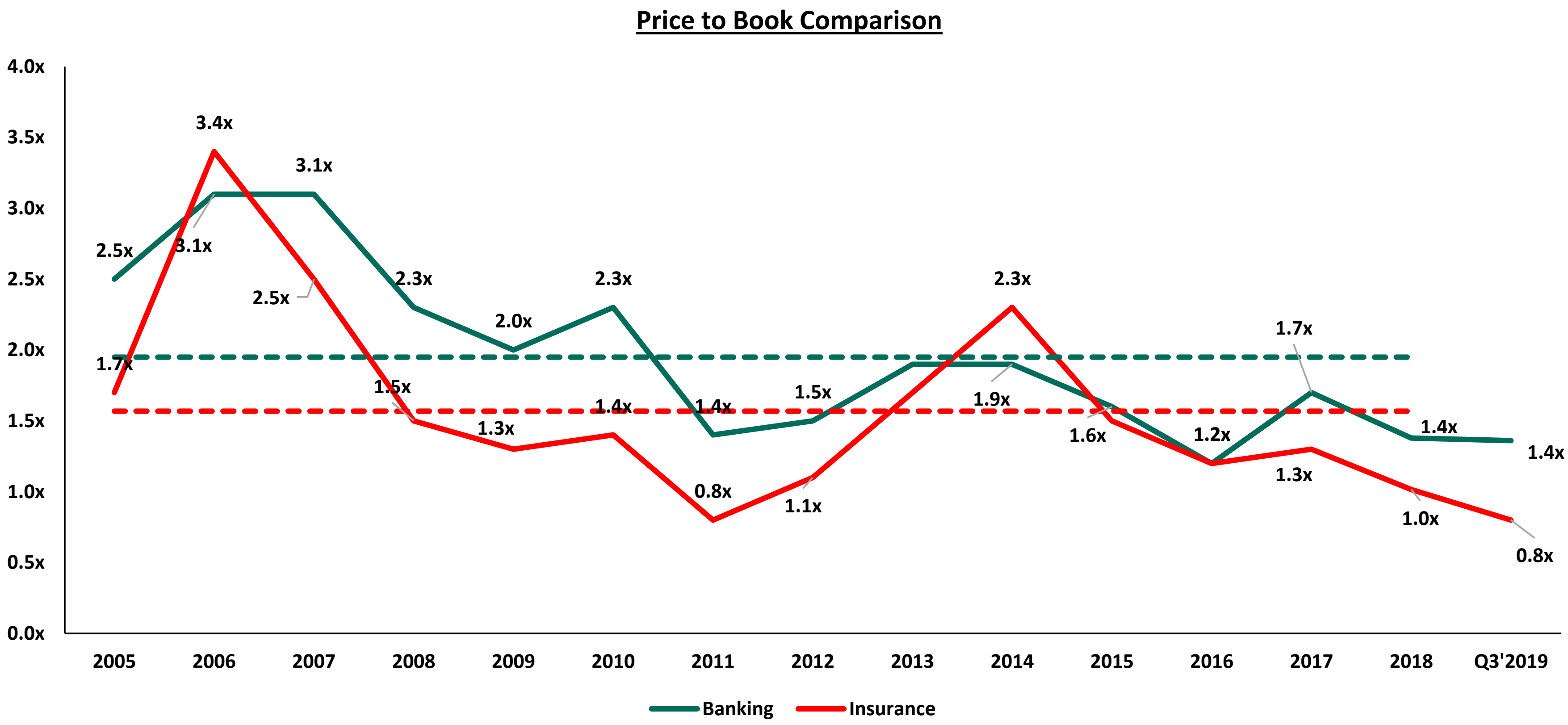
P/E calculation for HF used normalized earnings over a period of 5 years

**Prices as at 15th November 2019*

Listed Banks & Insurance Trading Metrics

Listed banks trade at an average P/B of 1.4x, higher than the insurance sector, which is priced at 0.8x. Both sectors are trading below their 14-year averages of 1.9x and 1.6x, respectively

14 year Price to Book Value: Banking and Insurance



On a price to book valuation, listed banks are currently priced at a PBV of 1.4x, higher than listed insurance companies at 0.8x, with both lower than their historical averages of 1.9x for the banking sector and 1.6x for the insurance sector

Summary of the Q3'2019 Earnings

Listed banks continued to record a relatively strong performance, aided by Non-Funded Income expansion as well as improvements in operational efficiency

1. The sector continued to record a positive performance, recording a market cap-weighted increase of 8.7% in core earnings per share in Q3'2019, with non-funded revenue expansion and cost rationalization strategies taking effect. Operational efficiency has continued to improve, as shown by the improvement in the cost to income without LLP ratio to 49.3%, from 50.1% in Q3'2018

2. The level of NPLs remains a concern within the banking sector, with the weighted average gross Non-Performing Loans (NPL) ratio for the listed banks rising to 9.8%, above the 5 year average of 8.2%, with the sectors touted as the main contributors being real estate, manufacturing and retail. If the asset deterioration trend persists, this will likely impact bank's bottom line due to the associated impairment charges, especially after the adoption of the new IFRS 9 standard

3. The sector continued to record a relatively strong balance sheet growth, as deposits grew by 11.0%, slower than loans which grew by 11.6%. Loan growth is faster than the 4.2% y/y growth recorded in Q3'2018, on higher segmented lending by banks to corporates, and secured borrowers

IV. Banks Valuation Reports

Ranking by Franchise Value

KCB emerged top in the franchise ranking with Housing Finance coming in last

Ranking	Bank	LDR	CIR	ROACE	NIM	PEG ratio	P/TBV	Deposits/ Branch	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non Interest Income/ Revenue	Camel Rating	Total Score
1	KCB	3	3	1	3	2	7	6	2	6	5	7	1	**46**
2	Co-op	2	5	4	4	5	6	8	5	7	2	4	3	**55**
3	I&M	5	1	6	7	3	4	3	8	3	4	6	7	**57**
4	Stanbic	1	9	3	6	8	5	1	6	5	9	1	5	**59**
5	Equity	6	4	2	2	4	10	9	3	9	7	3	2	**61**
6	Barclays	4	8	5	1	7	9	5	1	1	10	9	4	**64**
7	NCBA	8	7	8	9	1	3	4	7	4	8	2	9	**70**
8	DTBK	7	2	9	8	6	2	7	4	8	6	10	6	**75**
9	SCBK	10	6	7	5	10	8	2	9	2	3	8	8	**78**
10	HF	9	10	10	10	9	1	10	10	10	1	5	10	**95**

Valuation Summary of Listed Banks

Diamond Trust Bank presents the highest upside with an expected total return of 66.6%

(all values in Kshs unless stated otherwise)

Bank	Current Price	Target Price	Upside/(Downside)	Dividend Yield	Total Potential Return
DTBK	115.0	189.0	64.3%	2.3%	66.6%
I&M Holdings	49.0	75.2	53.5%	7.2%	60.7%
KCB Group	50.0	64.2	28.4%	7.0%	35.4%
SCBK	193.3	211.6	9.5%	9.8%	19.3%
Coop Bank	16.1	18.1	12.6%	6.2%	18.8%
Equity Bank	51.0	56.7	11.2%	3.9%	15.1%
Barclays Bank	12.5	13.0	4.1%	8.8%	12.9%
NCBA Group Plc	35.0	37.0	5.8%	3.6%	9.4%
Stanbic Holdings	112.0	103.1	(7.9%)	4.7%	(3.2%)
HF Group	6.0	4.2	(30.4%)	0.0%	(30.4%)

Cytonn Banking Report - Comprehensive Ranking

KCB emerged top of the ranking in terms of comprehensive ranking

CYTONN Q3'2019 COMPREHENSIVE RANKING				
Bank	Franchise Value Score	Intrinsic Value Score	Weighted Score	Q3'2019 Rank
KCB Group Plc	46	3	20.2	1
I&M Holdings	57	2	24.0	2
Co-operative Bank of Kenya Ltd	55	5	25.0	3
Equity Group Holdings Ltd	61	6	28.0	4
Stanbic Bank/Holdings	59	9	29.0	5
Barclays Bank	64	7	29.8	6
DTBK	75	1	30.6	7
NCBA Group Plc	70	8	32.8	8
SCBK	78	4	33.6	9
HF Group Plc	95	10	44.0	10

A. Tier I Banks

Cytonn

Equity Group’s Summary of Performance – Q3’2019

- Equity Group recorded a profit before tax growth of 10.4% to Kshs 24.8 bn, up from Kshs 22.4 bn in Q3’2018. Profit after tax grew by 10.6% to Kshs 24.8 bn in Q3’2019, from Kshs 22.4 bn in Q3’2018, with the difference in growth attributable to the marginal increase in the effective tax rate to 29.5% from 29.4% in Q3’2018
- Total operating income recorded an 11.2% growth to Kshs 54.8 bn, from Kshs 49.3 bn in Q3’2018. This was driven by a 13.7% growth in Non-Funded Income (NFI) to Kshs 22.6 bn, from Kshs 19.8 bn in Q3’2018, coupled with a 9.5% growth in Net Interest Income to Kshs 32.3 bn, from Kshs 29.5 bn in Q3’2018,
- Total operating expenses rose by 11.7% to Kshs 30.0 bn, from Kshs 26.9 bn in Q3’2018, largely driven by a 41.8% increase in Loan Loss Provisions (LLP) to Kshs 1.9 bn, from Kshs 1.3 bn in Q3’2018, coupled with a 12.8% rise in staff costs to Kshs 9.3 bn from Kshs 8.3 bn in Q3’2018, and a 8.9% growth in other operating expenses to Kshs 18.9 bn, from Kshs 17.3 bn in Q3’2018,
- The balance sheet recorded an expansion as total assets grew by 20.8% to Kshs 677.1 bn, from Kshs 560.4 bn in Q3’2018. The growth was supported by a 21.0% growth in loans and advances to Kshs 348.9 bn, from Kshs 288.4 bn in Q3’2018, coupled with a 7.7% growth in government Securities to Kshs 135.1 bn, from Kshs 125.3 bn in Q3’2018,
- Asset quality deteriorated as Gross Non-Performing Loans (NPLs) increased by 15.4% to Kshs 30.5 bn in Q3’2019, from Kshs 26.5 bn in Q3’2018. The NPL ratio, however, improved to 8.4% in Q3’2019 from 8.9% in Q3’2018.
- Going forward, we expect the bank’s growth to be driven by:
    a) **Increased channeled diversification**, which is likely to further improve on efficiency, with emphasis on alternative channels of transactions, as the bank rides on the digital revolution wave, thereby further improving the cost to income ratio by cost rationalization and revenue expansion.

Financial Statements Extracts

Equity Group's PAT is expected to grow at a 5-year CAGR of 19.2%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	37.6	41.4	46.9	54.7
Non Funded Income	27.6	25.9	30.3	38.9
Total Operating Income	**65.2**	**67.3**	**77.2**	**93.6**
Loan Loss Provision	3.4	3.7	4.1	5.2
Other Operating Expenses	34.8	35.1	39.0	46.9
Total Operating Expenses	**38.3**	**38.8**	**43.1**	**52.0**
Profit Before Tax	26.9	28.5	34.1	41.6
Profit After tax	18.9	19.8	23.9	29.1
% PAT Change YoY	**14.0%**	**4.8%**	**20.5%**	**21.8%**
EPS	5.0	5.3	6.3	7.7
DPS	2.0	3.2	2.5	2.8
Cost to Income	58.7%	57.7%	55.8%	55.6%
NIM	8.9%	8.5%	8.7%	8.7%
ROaE	21.6%	21.2%	22.1%	24.9%
ROaA	3.8%	3.6%	3.7%	4.2%
Balance Sheet	**2017**	**2018**	**2019e**	**2020f**
Net Loans and Advances	279.1	297.2	376.5	449.8
Government Securities	128.0	130.4	135.1	125.9
Other Assets	117.4	145.7	204.2	218.3
Total Assets	**524.5**	**573.4**	**715.8**	**794.0**
Customer Deposits	373.1	422.8	502.0	562.2
Other Liabilities	58.2	55.7	90.7	91.3
Total Liabilities	**431.3**	**478.4**	**592.7**	**653.5**
Shareholders Equity	93.1	94.1	122.0	139.5
Total Liabilities & Shareholders Equity	**524.5**	**573.4**	**715.8**	**794.0**
Book value Per share	24.7	24.9	32.3	37.0
% Change in BPS YoY	**13.6%**	**1.0%**	**29.7%**	**14.3%**

Valuation Summary

Equity Group is undervalued with a potential upside of 15.1%

Cost of Equity Assumptions:	29-Nov-19
Default Spread Adjusted Risk free rate	13.2%
Beta	0.9
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.5%
Cost of Equity	21.4%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	22.3%
Return on Average Equity 2023	28.5%
Justified Price to Book value per share	1.8x
Shareholder Equity - FY23e	212.8
Terminal Value-(Year 2023)	392.1

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intergrated DDM	63.7	40.0%	25.5
Residual Income	61.7	35.0%	21.6
PBV Multiple	38.3	20.0%	7.7
PE Multiple	39.1	5.0%	2.0
Fair Value			**56.7**
Current Price			**51.0**
Upside/(Downside)			11.2%
Dividend Yield			3.9%
Total Potential Return			**15.1%**

** Five years average yields on a 10 year Treasury bond*

II. KCB Group

KCB Group Summary of Performance – Q3'2019

- Profit before tax increased by 6.2% to Kshs 19.2 bn in Q3'2019, up from Kshs 18.0 bn in Q3'2018. Profit after tax grew by 6.1% to Kshs 19.2 bn in Q3'2019, from Kshs 18.0 bn in Q3'2018 with the effective tax rate remaining unchanged at 29.5%,
- Total operating income increased by 10.0% to Kshs 59.7 bn from Kshs 54.2 bn in Q3'2018. This was due to a 16.9% increase in Non-Funded Income (NFI) to Kshs 21.0 bn, from Kshs 17.9 bn in Q3'2018, coupled with a 6.5% increase in Net Interest Income (NII) to Kshs 38.7 bn from Kshs 36.3 bn in Q3'2018,
- Total operating expenses increased by 13.4% to Kshs 32.5 bn, from Kshs 28.6 bn, largely driven by a 224.2% rise in Loan Loss Provisions (LLP) to Kshs 5.8 bn in Q3'2019, from Kshs 1.8 bn in Q3'2018, coupled with a 6.2% rise in staff costs to Kshs 13.6 bn in Q3'2019, from Kshs 12.8 bn in Q3'2018,
- The balance sheet recorded an expansion as total assets increased by 11.7% to Kshs 764.3 bn, from Kshs 684.2 bn in Q3'2018,
- The bank's asset quality declined, with the NPL ratio increasing to 8.3% from 7.6% in Q3'2018 due to the faster growth in Gross Non-Performing Loans (NPLs) which outpaced the growth in loans. General Loan Loss Provisions increased by 15.0% to Kshs 19.2 bn, from Kshs 16.7 bn in Q3'2018.

Going forward, we expect the bank's growth to be driven by:

i. **Increased channeled diversification**, which is likely to help the bank to continue improving its operational efficiency. The benefits of this are already being felt, as the bank aligned its staff head count to its operational needs. Continued emphasis on these alternative channels of transactions, as the bank rides on the digital revolution wave, will likely lead to further cost to income ratio improvements by cost rationalization and NFI expansion.

Financial Statements Extracts

KCB Group's PAT is expected to grow at a 5-year CAGR of 15.9%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	48.4	48.8	54.0	68.0
Non Funded Income	23.0	23.0	27.1	29.5
Total Operating Income	71.4	71.8	81.1	97.5
Loan Loss Provision	5.9	2.9	4.8	8.0
Other Operating Expenses	36.4	35.0	36.2	41.0
Total Operating Expenses	**42.3**	**37.9**	**41.0**	**49.0**
Profit Before Tax	29.1	33.9	40.1	48.5
Profit After tax	19.7	24.0	28.1	34.0
% PAT Change YoY	**(0.0)**	**21.8%**	**17.0%**	**21.0%**
EPS	6.4	7.8	9.2	11.1
DPS	3.0	3.5	3.5	3.5
Cost to Income	59.2%	52.8%	50.5%	50.2%
ROE	19.5%	21.9%	24.1%	26.1%
ROA	3.2%	3.6%	3.9%	4.5%

Balance Sheet	2017	2018	2019f	2020f
Net Loans and Advances	422.7	455.9	505.7	558.0
Government Securities	110.0	120.1	145.7	156.9
Total Assets	**646.7**	**714.3**	**775.8**	**859.9**
Customer Deposits	499.5	537.5	598.4	658.3
Total Liabilities	**540.7**	**600.7**	**656.9**	**718.3**
Shareholders Equity	**106.0**	**113.7**	**118.9**	**141.6**
Book value Per share	34.6	37.1	37.0	44.1
% Change in BPS YoY	**11.1%**	**7.3%**	**(0.2%)**	**19.1%**

Valuation Summary

KCB Group is undervalued with a total potential return of 35.4%

Cost of Equity Assumptions:	29-Nov-19
Risk free rate *	13.2%
Beta	0.9
Country Risk Premium	7.6%
Cost of Equity	20.1%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.8%
Return on Average Equity 2023	22.5%
Terminal Price to Book value per share	1.2x
Shareholder Equity - FY23e	239.4
Terminal Value - (Year 2023)	311.3

Valuation Summary	Implied Price	Weighting	Weighted Value
Residual Income	64.0	35%	22.4
PBV Multiple	49.4	20%	9.9
PE Multiple	58.8	5%	2.9
DDM Integrated	72.5	40%	29.0
Target Price			**64.2**
Current Price			**50.0**
Upside/(Downside)			28.4%
Dividend Yield			7.0%
Total Return			**35.4%**

** Five years average yields on a 10 year Treasury bond*

III. Co-operative Bank

Cytonn

Co-operative Bank's Summary of Performance – Q3'2019

- Co-operative Bank recorded a profit before tax increase by 5.5% to Kshs 15.5 bn, up from Kshs 14.6 bn in Q3'2018. Profit after tax grew by 5.5% to Kshs 10.9 bn in Q3'2019, from Kshs 10.3 bn in Q3'2018
- Total operating income increased by 9.1%
- Total operating expenses increased by 11.3% to Kshs 19.8 bn, from Kshs 17.8 bn in Q3'2018, largely driven by the 66.8% rise in Loan Loss Provisions (LLP) to Kshs 2.1 bn from Kshs 1.3 bn in Q3'2018, coupled with the staff costs increase of 12.1% to Kshs 9.1 bn in Q3'2019 from Kshs 8.1 bn in Q3'2018,
- The balance sheet recorded an expansion as total assets grew by 9.1% to Kshs 440.8 bn in Q3'2019 from Kshs 404.2 bn in Q3'2018 owing to the increases in government securities by 13.6% to Kshs 94.6bn in Q3'2019 from Kshs 83.3 bn, coupled with increase in placements by 47.5% to Kshs 24.33 from Kshs 16.49 bn,
- The bank's asset quality improved, with the NPL ratio improving to 10.5%, from 11.2% in Q3'2018. The main sectors that contributed to the NPLs were trade, personal consumer, manufacturing and real estate
- Going forward, we expect the bank's growth to be driven by:
    a) **Refocus on the core operations-** Prior to Q3'2019 the bank preferred to diversify to increase NFI due to the declining interest income however, now that there is potential for increasing interest income, the bank should refocus on lending to private sector which will not only increase interest income but also, it will increase fees and commissions on loans
    b) **Maximize on the interest rate cap repeal-** With the repeal of the interest rate cap the bank does not have to focus on cherry-picking loans to ensure proper credit management, instead, they can price loans according to the level of risk which will increase their loans to deposits ratio and interest income

Financial Statements Extracts

Co-operative Bank's PAT is expected to grow at a 5-year CAGR of 12.1%

Income Statement	2017	2018	2019e	2020 f
Net Interest Income	28.1	30.8	30.7	34.9
Non Funded Income	13.5	12.9	16.7	18.2
Loan Loss Provision	3.6	1.8	2.1	2.4
Other Operating Expenses	21.7	23.9	26.5	26.1
Total Operating Expenses	25.3	25.7	28.6	28.5
Profit Before Tax	16.4	18.2	18.9	24.6
Profit After tax	11.4	12.7	13.2	17.2
% PAT Change YoY	**(10.0%)**	**11.6%**	**3.8%**	**30.0%**
EPS	1.9	2.2	2.3	2.9
DPS	0.8	1.0	1.0	1.0
Cost to Income	60.9%	58.8%	60.2%	53.8%
NIM	8.8%	9.1%	8.3%	8.7%
ROE	17.4%	18.3%	18.1%	21.0%
ROA	3.1%	3.2%	3.1%	3.7%

Balance Sheet	2017	2018	2019e	2020f
Net Loans and Advances	253.9	245.4	277.0	295.5
Government Securities	44.0	49.7	61.5	57.6
Other Assets	89.0	118.3	112.9	131.5
Total Assets	**386.9**	**413.4**	**451.4**	**484.6**
Customer Deposits	287.4	306.1	330.6	352.1
Other Liabilities	29.2	36.1	43.1	43.5
Total Liabilities	**316.6**	**342.2**	**373.7**	**395.6**
Shareholders Equity	69.6	69.9	76.3	87.6
Book value Per share	11.9	11.9	13.0	14.9
% Change in BPS YoY	**13.5%**	**13.9%**	**9.2%**	**14.8%**

Valuation Summary

Co-operative Bank is undervalued with a potential return of 18.8%

Cost of Equity Assumptions:	29-Nov-19
Risk free rate *	13.2%
Beta	0.9
Country Risk Premium	7.6%
Extra Risk Premium	0.9%
Cost of Equity	20.9%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	21.7%
Return on Average Equity	18.7%
Terminal Price to Book value per share	1.1x
Shareholder Equity - FY23e	127.3
Terminal Value-(Year 2023)	147.0

	Implied Price	Weighting	Weighted Value
DDM Integrated	21.89	40%	8.76
Residual income	14.71	35%	5.15
PBV Multiple	16.64	20%	3.33
PE Multiple	16.74	5%	0.84
Target Price			**18.1**
Current Price			**16.1**
Upside/(Downside)			12.6%
Dividend Yield			6.2%
Total Return			**18.8%**

** Five years average yields on a 10 year Treasury bond*

IV. NCBA Bank

Cytonn

NCBA Summary of Performance – Q3'2019

- Profit before tax and exceptional items increased by 23.9% to Kshs 11.6 bn from Kshs 9.4 bn in Q3'2018. Profit after tax increased by 26.5% to Kshs 8.4 bn in Q3'2019 from Kshs 6.6 bn in Q3'2018,
- Total operating income increased by 15.2% to Kshs 30.5 bn from Kshs 26.5 bn in Q3'2018. This was driven by both, a 8.8% increase in Net Interest Income (NII) to Kshs 16.1 bn from Kshs 14.8 bn in Q3'2018, and a 23.3% increase in Non-Funded Income (NFI) to Kshs 14.4 bn from Kshs 11.7 bn in Q3'2018,
- Total operating expenses increased by 10.4% to Kshs 18.9 bn from Kshs 17.2 bn, largely driven by a 12.3% increase in loan loss provision (LLP) to Kshs 4.3 bn in Q3'2019 from Kshs 3.8 bn in Q3'2018. Staff costs, also increased by 10.2% to Kshs 6.2 bn in Q3'2019 from Kshs 5.7 bn in Q3'2018,
- The balance sheet recorded an expansion with total assets growth of 9.8% to Kshs 487.9 bn from Kshs 444.4 bn in Q3'2018. This growth was largely driven by a 7.4% increase in government securities to Kshs. 147.7 bn from Kshs. 137.5 bn in Q3'2018,

Going forward, we expect the bank's growth to be driven by:

a) The merger with CBA will likely enable NIC to mobilize cheaper funding, leveraging on the scale and market reach of the combined entity as well as the digital channels. We expect NCBA Group Plc to focus on branding and increased consumer awareness campaigns in the near term, as they endeavor to minimize service disruptions to clientele as well as highlight the synergies and benefits expected to be reaped from the merger

NCBA Combined Financial Statements

NCBA's PAT is expected to grow at a 5-year CAGR of 14.3%

Income Statement	2017	2018	2019f	2020f
Net Interest Income	20.4	20.3	22.3	27.6
Non Funded Income	14.6	16.1	16.8	18.6
Loan Loss Provision	6.0	6.1	5.7	6.6
Total Operating Expenses	22.7	24.1	24.6	27.9
Profit Before Tax	12.4	12.3	14.5	18.3
Profit After tax	8.2	8.9	10.6	12.8
% PAT Change YoY		**9.3%**	**18.3%**	**20.9%**
EPS	5.5	6.0	7.1	8.5
DPS	1.0	1.3	1.3	1.3
Cost to Income	64.7%	66.3%	63.0%	60.5%
NIM	5.6%	5.2%	5.4%	6.4%
ROE	13.6%	13.7%	15.3%	16.4%
ROA	1.9%	2.0%	2.2%	2.5%

Balance Sheet	2017	2018e	2019f	2020f
Net Loans and Advances	233.4	239.6	253.0	273.2
Government Securities	120.2	129.7	141.6	140.7
Other Assets	98.3	84.3	104.8	127.5
Total Assets	**452.0**	**453.6**	**499.3**	**541.4**
Customer Deposits	332.7	341.0	377.6	407.8
Other Liabilities	54.4	46.2	49.2	49.5
Total Liabilities	**387.1**	**387.2**	**426.8**	**457.3**
Shareholders Equity	64.4	66.0	72.3	83.9
Book value Per share	43.0	44.1	48.3	56.0

Valuation Summary

NCBA is undervalued with a potential return of 9.4%

Cost of Equity Assumptions:	29-Nov-19
Default Spread Adjusted Risk free rate	13.20%
Beta	1.8
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.0%
Cost of Equity	28.7%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	21.8%
Return on Average Equity	14.0%
Terminal Price to Book	0.5x
Shareholder Equity - FY23e	127.2
Terminal Value-(Year 2023)	71.4

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	38.9	40%	15.6
Residual Valuation	19.8	35%	6.9
PBV Multiple	60.1	20%	12.0
PE Multiple	49.1	5%	2.5
Target Price			**37.0**
Current Price			**35.0**
Upside/(Downside)			5.8%
Dividend Yield			3.6%
Total Potential Return			**9.4%**

** Five years average yields on a 10 year Treasury bond*

V. Standard Chartered Bank Kenya

SCBK's Summary of Performance – Q3'2019

- Profit before tax decreased by 1.2% to Kshs 9.1 bn, from Kshs 9.2 bn in Q3'2018. Profit after tax declined by 1.3% to Kshs 6.2 bn in Q3'2019, from Kshs 6.3bn in Q3'2018
- Total operating income remained flat at Kshs 21.6 bn, unchanged from Q3'2018. This was due to a 1.1% decline in Non-Funded Income (NFI) to Kshs 6.96 bn from Kshs 7.04 bn in Q3'2018, which offset the 0.6% increase in Net Interest Income (NII) to Kshs 14.7 bn from Kshs 14.6 bn in Q3'2018,
- Total operating expenses increased by 0.9% to Kshs 12.5 bn from Kshs 12.4 bn in Q3'2018, largely driven by a 9.8% increase in staff costs to Kshs 5.6 bn from Kshs 5.1 bn in Q3'2018 and a 16.8% increase in other operating expenses to Kshs 4.9 bn from Kshs 4.2 bn in Q3'2018. The increases were however mitigated by a 61.2% decline in in loan loss provisions to Kshs 728.2 mn, from Kshs 1.9 bn in Q3'2018,
- The balance sheet recorded an expansion as total assets increased by 0.7% to Kshs 290.6 bn, from Kshs 288.6 bn in Q3'2018,
- The bank's asset quality deteriorated, with the NPL ratio increasing to 14.9% from 14.2% in Q3'2018. due to the faster growth in gross Non-performing Loans (NPLs), which outpaced the growth in gross loans.

Going forward, we expect the bank's growth to be driven by:

a) Continued focus on promoting the usage of the bank's alternative channels is likely to boost the company's Non-Funded Income (NFI) as well as aiding in improving operational efficiency levels, which deteriorated in Q3'2019 as evidenced by the worsening of the cost to income ratio to 57.7% from 57.2% in Q3'2018. Revenue expansion coupled with cost containment will be key in boosting the bank's bottom line.

Financial Statements Extracts

SCBK's PAT is expected to grow at a 5-year CAGR of 8.3%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	18.6	19.4	20.1	21.7
Non Funded Income	8.8	9.2	9.8	10.6
Total Operating Income	**27.3**	**28.6**	**29.9**	**32.2**
Loan Loss Provision	4.2	1.9	1.9	2.0
Other Operating Expenses	13.1	14.8	15.0	15.7
Total Operating Expenses	**17.3**	**16.8**	**16.9**	**17.7**
Profit Before Tax	10.1	11.8	13.0	14.5
Profit After tax	6.9	8.1	8.9	9.9
% PAT Change YoY	**(23.6%)**	**17.1%**	**9.8%**	**11.1%**
EPS	20.1	23.6	25.9	28.7
DPS	17.0	19.0	20.7	23.0
Cost to Income	63.2%	58.6%	56.4%	55.0%
NIM	7.9%	7.5%	7.9%	8.3%
ROaE	15.4%	17.5%	19.7%	22.2%
ROaA	2.6%	2.8%	3.1%	3.3%
Balance Sheet	**2017**	**2018e**	**2019e**	**2020f**
Net Loans and Advances	126.3	118.7	128.1	134.5
Government Securities	110.5	98.7	103.0	108.1
Other assets	48.9	68.0	58.7	60.6
Total Assets	**285.7**	**285.4**	**289.8**	**303.2**
Customer Deposits	213.3	224.3	228.8	240.2
Other Liabilities	26.7	14.5	17.5	17.5
Total Liabilities	**240.1**	**238.8**	**246.3**	**257.8**
Shareholders Equity	45.7	46.6	43.5	45.4
Total Liabilities and Shareholders Equity	**285.7**	**285.4**	**289.8**	**303.2**
Book value Per share	132.9	135.8	126.5	132.3
% Change in BPS YoY	**4.0%**	**2.1%**	**(6.8%)**	**4.5%**

Valuation Summary

SCBK is undervalued with a total potential total return of 19.3%

Cost of Equity Assumptions:	29-Nov-19
Default Spread Adjusted Risk free rate	13.2%
Beta	0.8
Mature Market Risk Premium	7.6%
Extra Risk Premium	0.0%
Cost of Equity	19.3%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	20.8%
Return on Average Equity 2023	24.1%
Terminal Price to Book value per share	1.8x
Shareholder Equity - FY23e	52.2
Terminal Value-(Year 2023)	98.6

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	229.61	40%	91.84
Residual Income	216.30	35%	75.70
PBV Multiple	178.63	20%	35.73
PE Multiple	166.82	5%	8.34

Target Price	**211.6**
Current Price	**193.3**
Upside/(Downside)	9.5%
Dividend Yield	9.8%
Total Return	**19.3%**

** Five years average yields on a 10 year Treasury bond*

VI. Diamond Trust Bank Kenya

Cytonn

DTBK's Summary of Performance – Q3'2019

- DTBK recorded a profit before tax increase of 5.8% to Kshs 8.7 bn, up from Kshs 8.2 bn in Q3'2018. Profit after tax grew by by 6.5% to Kshs 6.0 bn in Q3'2019, from Kshs 5.6 bn in Q3'2018
- Total operating income decreased by 4.6% to Kshs 18.2 bn, from Kshs 19.0 bn in Q3'2018. This was due to a 7.5% decrease in Net Interest Income (NII) to Kshs 13.8 bn from Kshs 14.9 bn in Q3'2018, that outpaced the 5.7% growth in Non-Funded Income (NFI) to Kshs 4.4 bn, from Kshs 4.1 bn in Q3'2018
- Total operating expenses decreased by 12.5% to Kshs 9.5 bn from Kshs 10.8 bn, largely driven by a 63.7% decrease in loan loss provision (LLP) to Kshs 870.3 mn in Q3'2019, from Kshs 2.4 bn in Q3'2018. The decline was however mitigated by the 8.5% increase in staff costs to Kshs 3.4 bn in Q3'2019, from Kshs 3.1 bn in Q3'2018
- The balance sheet recorded a contraction as total assets declined by 0.6% to Kshs 382.5 bn from Kshs 385.0 bn in Q3'2018. This decrease was largely driven by a 1.2% decrease in government securities to Kshs 97.5 bn in Q3'2019, from Kshs 98.7 bn in Q3'2018, coupled with a 2.9% contraction of the loan book to Kshs 192.0 bn in Q3'2019, from Kshs 197.7 bn in Q3'2018. The decline was however mitigated by the 55.8% growth in other assets to Kshs 14.4 bn, from Kshs 9.3 bn in Q3'2018
- Gross non-performing loans increased by 9.6% to Kshs 17.9 bn in Q3'2019, from Kshs 16.3 bn in Q3'2018. The NPL ratio thus deteriorated to 8.9% in Q3'2019, from 7.8% in Q3'2018. General loan loss provisions recorded a 38.4% decline to Kshs 5.7 bn, from Kshs 9.3 bn in Q3'2018.

Going forward, we expect the DTBK's growth to be driven by:

a) **Regional diversification**: We continue to expect DTBK's increased regional presence to aid in enhancing growth. We expect DTBK's increased focus on other regions to boost the growth in the bottom line, largely supported by the expansion of funded income which has remained subdued largely due to the pricing restriction existent in Kenya.

Financial Statements Extracts

DTBK's PAT is expected to grow at a 5-year CAGR of 7.3%

Income Statement	2017	2018	2019e	2020e
Net Interest Income	19.7	20.0	18.4	19.7
Non Funded Income	5.3	5.4	5.8	5.9
Total Operating Income	**25.0**	**25.5**	**24.2**	**25.6**
Loan Loss Provision	4.3	3.0	1.4	1.0
Other Operating Expenses	10.6	11.5	11.2	11.9
Total Operating Expenses	**14.9**	**14.5**	**12.7**	**12.9**
Profit Before Tax	10.1	11.0	11.6	12.7
Profit After tax	6.9	7.1	7.9	8.7
% PAT Change YoY	**(10.3%)**	**2.3%**	**11.4%**	**9.7%**
EPS	24.8	25.3	28.2	31.0
DPS	2.6	2.6	2.8	3.1
Cost to Income	42.3%	45.2%	46.3%	46.4%
NIM	6.5%	6.2%	5.7%	6.0%
ROaE	12.9%	13.9%	12.6%	12.0%
ROaA	2.0%	1.9%	1.9%	2.1%
Balance Sheet	**2017**	**2018e**	**2019e**	**2020e**
Net Loans and Advances	196.0	193.1	201.1	207.0
Government Securities	114.4	117.3	110.6	113.8
Other Assets	52.9	67.3	83.3	90.4
Total Assets	**363.3**	**377.7**	**395.0**	**411.2**
Customer Deposits	266.2	282.9	287.3	295.7
Other Liabilities	43.4	35.9	36.2	36.7
Total Liabilities	**309.7**	**318.8**	**323.6**	**332.4**
Shareholders Equity	48.4	53.7	65.6	73.1
Total Liabilities and Shareholder Equity	**363.3**	**377.7**	**395.0**	**411.2**
Book value Per share	173.0	191.9	234.8	261.3
% Change in BPS YoY	**17.9%**	**10.9%**	**22.3%**	**11.3%**

Valuation Summary

DTBK is undervalued with a potential upside of 66.6%

Cost of Equity Assumptions:	29-Nov-19
Default Spread Adjusted Risk free rate*	13.3%
Beta	0.7
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.5%
Cost of Equity	19.8%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	22.4%
Return on Average Equity 2023	10.3%
Terminal Price to Book value per share	0.8x
Shareholder Equity - FY20e	91.4
Terminal Value-(Year 2023)	86.1

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	223.6	40.0%	89.4
Residual Income	103.2	35.0%	36.1
PBV Multiple	265.0	20.0%	53.0
PE Multiple	208.6	5.0%	10.4
Target Price			**189.0**
Current Price			**115.0**
Upside/(Downside)			64.3%
Dividend yield			2.3%
Total return			**66.6%**

** Five years average yields on a 10 year Treasury bond*

VII. Barclays Bank of Kenya

Cytonn

Barclays Bank's Summary of Performance – Q3'2019

- Profit before tax increased by 17.8% to Kshs 9.1 bn, up from Kshs 7.7 bn in Q3'2018. Profit after tax grew by 19.0% to Kshs 6.5 bn in Q3'2019, from Kshs 5.4 bn in Q3'2018 as the effective tax rate remaining unchanged at 32.1%,
- Total operating income increased by 3.9% to Kshs 24.8 bn from Kshs 23.9 bn in Q3'2018. This was due to a 8.1% increase in Non-Funded Income (NFI) to Kshs 8.0 bn, from Kshs 7.4 bn in Q3'2018, coupled with a 2.0% increase in Net Interest Income (NII) to Kshs 16.8 bn from Kshs 16.5 bn in Q3'2018,
- Total operating expenses decreased by 2.7% to Kshs 15.7 bn, from Kshs 16.1 bn, largely driven by a 9.7% decrease in other expenses to Kshs 5.3 bn in Q3'2019, from Kshs 5.9 bn in Q3'2018, coupled with a 1.6% decrease in staff costs to Kshs 7.3 bn in Q3'2019, from Kshs 7.5 bn in Q3'2018,
- The balance sheet recorded an expansion as total assets increased by 11.7% to Kshs 359.8 bn, from Kshs 322.2 bn in Q3'2018. This growth was largely driven by an 8.8% increase in the loan book to Kshs 194.2 bn from Kshs 178.4 bn in Q3'2018,
- Asset quality improved, as highlighted by the drop in the NPL ratio to 6.8% from 7.7% in Q3'2018. Main sectors that continue to experience challenges include trade, manufacturing and retail,
- Going forward, we expect the bank's growth to be driven by:
    a) Increased Channel diversification, which is likely to help the bank to continue improving its operational efficiency. The benefits of this are already being felt with "Timiza" already recording an accelerated growth, and consequently higher Non-Interest Revenue. This, coupled with the expansion of its agent banking network and product offerings such as banc assurance and fixed income trading will see the bank expand its topline revenue, going forward.

Financial Statements Extracts

Barclays Bank's PAT is expected to grow at a 5-year CAGR of 13.7%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	21.8	22.0	23.8	28.3
Non Funded Income	8.5	9.7	10.8	11.7
Total Operating Income	**30.3**	**31.7**	**34.6**	**40.0**
Loan Loss Provision	3.1	3.9	5.1	5.8
Other Operating Expenses	16.8	17.2	18.4	19.7
Total Operating Expenses	**19.9**	**21.0**	**23.5**	**25.5**
Profit Before Tax	10.4	10.6	11.1	14.5
Profit After tax	**6.9**	**7.4**	**7.8**	**10.2**
% PAT Change YoY	**(6.4%)**	**7.1%**	**5.1%**	**30.4%**
EPS	1.3	1.4	1.4	1.9
DPS	1.0	1.1	1.1	1.5
Cost to Income	55.5%	54.2%	53.1%	49.3%
NIM	9.7%	8.6%	8.2%	9.6%
ROaE	16.0%	16.8%	17.3%	21.7%
ROaA	2.7%	2.7%	2.4%	3.1%
Balance Sheet	**2017**	**2018**	**2019e**	**2020f**
Net Loans and Advances	168.4	177.4	213.9	228.7
Government Securities	58.5	92.9	80.0	85.5
Other Assets	44.3	54.5	86.5	86.1
Total Assets	**271.2**	**324.8**	**380.5**	**400.3**
Customer Deposits	186.0	207.4	251.7	269.0
Other Liabilities	41.1	73.2	83.3	83.7
Total Liabilities	**227.1**	**280.6**	**334.9**	**352.7**
Shareholders Equity	44.1	44.2	45.8	47.8
Total Liabilities and Shareholders Equity	**271.2**	**324.8**	**380.7**	**400.3**
Book value Per share	8.1	8.1	8.4	8.8
% Change in BPS YoY	**4.0%**	**0.2%**	**3.5%**	**4.4%**

Valuation Summary

Barclays Bank is undervalued with a potential return of 12.9%

Cost of Equity Assumptions:	29-Nov-19
Default Spread Adjusted Risk free rate	13.2%
Beta	0.90
Mature Market Risk Premium	7.6%
Extra Risk Premium	0.0%
Cost of Equity	19.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.8%
Return on Average Equity 2023	28.0%
Terminal Price to Book value per share	1.5x
Shareholder Equity - FY23e	55.5
Terminal Value-(Year 2023)	84.5

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	13.1	40%	5.2
Residual Income	14.7	35%	5.1
PBV Multiple	10.5	20%	2.1
PE Multiple	9.7	5%	0.5
Target Price			**13.0**
Current Price			**12.5**
Upside/(Downside)			4.1%
Dividend Yield			8.8%
Total Return			**12.9%**

** Five years average yields on a 10 year Treasury bond*

VIII. Stanbic Holdings

Stanbic Bank Summary of Performance – Q3’2019

- Stanbic Bank recorded a profit before tax of Kshs 6.7 bn in Q3’2019 similar to Q3’2018. Profit after tax recorded a growth of 7.9% to Kshs 5.1 bn in Q3’2019, from Kshs 4.7 bn in Q3’2018
- Total operating income increased by 15.2% to Kshs 18.4 bn, from Kshs 15.9 bn in Q3’2018, driven by a 12.6% increase in Net Interest Income to Kshs 9.6 bn in Q3’2019, from Kshs 8.5 bn in Q3' 2018, coupled with a 18.3% increase in Non-Funded Income to Kshs 8.8 bn, from Kshs 7.4 bn in Q3’2018,
- Total operating expenses increased by 26.3% to Kshs 11.7 bn in Q3’2019 from Kshs 9.2 bn in Q3’2018, largely driven by a 31.2% increase in the loan loss provision to Kshs 1.7 bn from Kshs 1.2 bn in Q3’2018. Staff costs also recorded a 0.1% increase to Kshs 4.3 bn from Kshs 4.2 bn in Q3’2018. Consequentially, Cost to income ratio with LLP deteriorated to 63.5% in Q3’2019 from 57.9% in Q3’2018,
- The balance sheet recorded an expansion as total assets increased by 2.8% to Kshs 294.3 bn from Kshs 286.3 bn in Q3’2018. This growth was largely driven by a 14.6% increase in the loan book to Kshs 161.7 bn from Kshs 141.1 bn,
- The bank experienced a deterioration in asset quality, as Gross non-performing loans increased by 78.3% to Kshs 18.9 bn from Kshs 10.6 bn in Q3’2018. Consequently, the NPL ratio deteriorated to 10.9% from 7.5% in Q3’2018
- Going forward, we expect the bank’s growth to be driven by:
    a) **Efficient operating model-**The bank’s increased focus on cost containment is likely to boost the bank’s growth prospects, as it looks to drive its strategy of increased deposit mobilization capacity and lending. This will likely ring in additional interest income, thereby improving the top line revenue. Furthermore, the banks well diversified revenue structure will likely buffer the bottom in the event of a significant decline in one of the revenue streams

Financial Statements Extracts

Stanbic Holdings PAT is expected to grow at a 5-year CAGR of 10.2%

Income Statement	2017	2018	2019e	2020f
Net Interest Income	10.6	12.1	14.9	15.3
Non Funded Income	8.4	10.0	11.9	14.1
Total Operating Income	**19.1**	**22.1**	**26.8**	**29.4**
Loan Loss Provision	2.8	2.1	2.8	3.1
Other Operating Expenses	10.9	11.1	13.5	15.0
Total Operating Expenses	**13.7**	**13.1**	**16.3**	**18.1**
Profit Before Tax	5.4	9.0	10.5	11.3
Profit After tax	4.3	6.3	7.3	7.9
% PAT Change YoY	**(2.5%)**	**45.8%**	**16.5%**	**8.1%**
EPS	10.9	15.9	18.5	20.0
DPS	5.3	5.8	4.6	5.0
Cost to Income	71.7%	59.5%	60.9%	61.6%
NIM	**5.1%**	**5.0%**	**5.4%**	**4.9%**
ROaE	10.4%	14.3%	15.8%	15.4%
ROaA	1.9%	2.3%	2.4%	2.4%
Balance Sheet	**2017**	**2018e**	**2019e**	**2020f**
Net Loans and Advances	143.3	175.0	196.5	218.3
Other Assets	105.5	115.6	123.0	135.1
Total Assets	**248.7**	**290.6**	**319.5**	**353.3**
Customer Deposits	193.4	219.5	242.7	270.7
Borrowings	4.0	7.1	9.2	9.2
Other Liabilities	8.4	19.4	19.3	19.3
Total Liabilities	**205.8**	**245.9**	**271.2**	**299.2**
Shareholders Equity	43.0	44.6	48.3	54.2
Total Liabilities and Shareholders Equity	**248.7**	**290.6**	**319.5**	**353.3**
Book value Per share	108.7	112.9	122.1	137.1
% Change in BVPS	**7.0%**	**3.9%**	**8.1%**	**12.3%**

Valuation Summary

Stanbic Holdings is fairly valued with a potential return of -2.7%

Cost of Equity Assumptions:	29-Nov-19
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.8
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.0%
Cost of Equity	20.1%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	21.8%
Return on Average Equity 2023f	14.2%
Terminal Price to Book value per share	0.8x
Shareholder Equity - FY23e	75.4
Terminal Value-(Year 2023)	66.5

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	110.0	40%	44.0
Residual Income	101.0	35%	35.4
PBV Multiple	94.1	20%	18.8
PE Multiple	99.5	5%	5.0
Target Price			**103.1**
Current Price			**112.0**
Dividend Yield			**5.2%**
Upside/(Downside)			**-2.7%**

** Five years average yields on a 10 year Treasury bond*

B. Tier II Banks

I. I&M Holdings

I&M Holdings Summary of Performance – Q3’2019

- Profit before tax recorded a 12.2% growth to Kshs 9.3 bn from Kshs 8.3 bn in Q3’2018. Profit after tax increased by 13.4% to Kshs 6.3 bn in Q3’2019 from Kshs 5.5 bn recorded in a similar period in 2018
- Total operating income increased by 6.8% to Kshs 16.9 bn from Kshs 15.8 bn in Q3’2018. This was due to a 14.0% increase in Non-Funded Income (NFI) to Kshs 6.3 bn from Kshs 5.6 bn in Q3’2018, coupled with a 2.9% growth in Net Interest Income (NII) to Kshs 10.6 bn from Kshs 10.3 bn recorded in Q3’2018,
- Total operating expenses posted a marginal growth of 0.5% to Kshs 8.23 bn from Kshs 8.18 bn, largely driven by a 13.6% increase in staff costs to Kshs 3.5 bn in Q3’2019 from Kshs 3.1 bn in Q3’2018, coupled with a 31.6% decline in Loan loss provisions (LLP) to Kshs 1.3 bn in Q3’2019 from Kshs 1.9 bn in Q3’2018,
- The balance sheet recorded an expansion with total assets growth of 12.0% to Kshs 324.3 bn from Kshs 289.6 bn recorded in Q3’2018,
- The bank experienced a deterioration in asset quality, as Gross non-performing loans increased by 8.9% while NPL coverage improved to 62.5% in Q3’2019 from 49.2% in Q3’2018. Further, general loan loss provisions increased by 40.3% to Kshs 8.3 bn from Kshs 5.9 bn in Q3’2018, hence an improvement in NPL coverage

Going forward, we expect the bank’s growth to be driven by:

a) **NFI 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

b) **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.

Financial Statement Extracts

I&M Holdings PAT is expected to grow at a 5-year CAGR of 12.5%

Income Statement	2017	2018	2019f	2020f
Net Interest Income	15.6	15.6	16.7	18.0
Non- Funded Income	5.8	7.6	9.4	10.4
Total Operating Income	**21.3**	**23.2**	**26.1**	**28.4**
Loan Loss Provision	4.1	3.8	4.4	5.0
Other Operating Expenses	7.8	8.5	9.9	10.8
Total Operating Expenses	**12.0**	**12.3**	**14.3**	**15.8**
Profit Before Tax	9.9	11.5	12.4	13.2
Profit After Tax	7.3	8.5	8.7	9.3
% PAT Change YoY	**(6.4%)**	**17.1%**	**2.5%**	**6.4%**
EPS	17.6	20.6	10.5	11.2
DPS	3.5	3.9	3.9	3.9
Cost to Income	56.2%	53.0%	54.6%	55.5%
NIM	8.8%	6.7%	6.1%	6.3%
ROaE	16.6%	17.2%	15.9%	15.8%
ROaA	3.0%	3.0%	2.6%	2.6%
Balance Sheet	**2017**	**2018**	**2019f**	**2020f**
Government securities	51.7	52.2	55.3	58.9
Net Loans and Advances	153.0	166.7	181.8	203.5
Other Assets	35.4	69.6	98.6	104.0
Total Assets	**240.1**	**288.5**	**335.7**	**366.5**
Customer Deposits	169.3	213.1	245.7	267.8
Other Liabilities	23.8	24.5	32.0	33.1
Total Liabilities	**193.1**	**237.6**	**277.7**	**300.9**
Shareholders Equity	44.3	47.9	54.9	62.4
Total Liabilities and Shareholders Equity	**240.1**	**288.5**	**335.7**	**366.5**
Book Value Per Share	107.2	115.8	66.4	75.5
% BVPS Change YoY	**13.6%**	**8.0%**	**-42.6%**	**13.7%**

Valuation Summary

I&M Holdings is undervalued with a total potential return of 60.7%

Cost of Equity Assumptions:	
Default Spread Adjusted Risk free rate	13.2%
Beta	0.9
Mature Market Risk Premium	7.6%
Extra Risk Premium	0.5%
Cost of Equity	20.5%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	0.9
Terminal Cost of Equity	20.53%
Return on Average Equity 2023	**16.7%**
Terminal Price to Book value per share	**1.1x**
Shareholder Equity - FY23e	92.9
Terminal Value-(Year 2023)	107.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	82.72	40%	33.09
Residual income	77.64	35%	27.17
PBV Multiple	59.75	20%	11.95
PE Multiple	59.04	5%	2.95
Target Price			**75.2**
Current Price			**49.0**
Upside/(Downside)			53.5%
Dividend yield			7.2%
Total return			**60.7%**

** Five years average yields on a 10 year Treasury bond*

II. HF Group

HF Group Summary of Performance – Q3’2019

- HF Group recorded a loss before tax of Kshs 81.4 mn from a loss before tax of Kshs 325.6 mn in Q3’2018. HF Group also recorded a loss after tax of Kshs 84.6 mn from a loss after tax of Kshs 332.0 mn in Q3’2018
- Total operating income increased by 16.5% to Kshs 2.8 bn, from Kshs 2.4 bn in Q3’2018. This was mainly driven by a 78.9% increase in Non-Funded Income (NFI) to Kshs 1.1 bn, from Kshs 0.6 bn in Q3’2018. This was however weighed down by a 4.3% decline in Net Interest Income (NII) to Kshs 1.7 bn from Kshs 1.8 bn in Q3’2018,
- Total operating expenses increased by 5.6% to Kshs 2.9 bn from Kshs 2.7 bn in Q3’2018, largely driven by a 64.5% increase in loan loss provisions to Kshs 0.6 bn from Kshs 0.4 bn in Q3’2018. This was however offset by a 17.2% decline in Staff costs to Kshs 0.7 bn from Kshs 0.9 bn, in Q3’2018,
- The balance sheet recorded a contraction as total assets declined by 9.4% to Kshs 57.4 bn, from Kshs 63.4 bn in Q3’2018. The contraction was mainly driven by a 13.7% decline in the loan book to Kshs 39.2 bn from Kshs 45.4 bn in Q3’2018,
- The bank experienced a deterioration in asset quality, with gross non-performing loans (NPLs) rising by 41.4% to Kshs 12.6 bn in Q3’2019, from Kshs 8.9 bn in Q3’2018. This warranted increased provisioning by 17.1% to Kshs 2.7 bn, from Kshs 2.3 bn in Q3’2018. The deteriorating asset quality, coupled with the tough operating environment occasioned by the interest rate cap, has continued to hamper the bank’s lending activities, leading to a decline in its interest income

HF Group Summary of Performance – Q3’2019

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

1. Continued investment in digital channels to enhance accessibility as well as reduce operating expenses mainly through aligning staff costs to the bank’s operational needs: On this end, the Bank undertook a redundancy exercise in 2018 in a cost-cutting drive, which saw the merging of some staff positions. This is expected to improve efficiencies in subsequent periods by providing clarity on operational accountabilities and curb the high operational costs, and,
2. We maintain our view that HF Group as a conventional bank has a long way to go, given its inability to mobilize deposits evidenced by the slow deposit growth. Furthermore, the removal of the Interest rate cap will ultimately increase competition among banks in terms of credit offerings. The bank will ultimately have to adjust its business model, or couple up with a strong bank with a sizeable asset base, and a strong deposit gathering capability, in an effort to capitalize on HF’s strength in mortgages and real estate development.

Financial Statements Extracts

HF Group’s PAT is expected to increase at a 5-year CAGR of 5%

Income Statement	2017	2018	2019f	2020f
Net Interest Income	3.0	2.3	2.9	2.2
Non Funded Income	1.3	1.3	1.5	1.6
Total Operating Income	**4.3**	**3.6**	**4.3**	**3.8**
Loan Loss Provision	0.6	0.4	0.6	0.6
Other Operating Expenses	3.4	3.9	3.9	3.6
Total Operating Expenses	**4.0**	**4.2**	**4.5**	**4.2**
Profit Before Tax	0.3	(0.6)	(0.1)	(0.4)
Profit After tax	0.1	(0.6)	(0.1)	(0.3)
% PAT Change YoY	**(86.1%)**	**(573.9%)**	**(87.0%)**	**236.2%**
EPS	0.4	(1.6)	(0.2)	(0.7)
DPS	0.0	0.0	0.0	0.0
Cost to Income	78.9%	107.7%	88.6%	93.9%
NIM	5.2%	4.4%	5.9%	4.5%
ROE	1.1%	(5.5%)	(0.8%)	(2.6%)
ROA	0.2%	(0.9%)	(0.1%)	(0.4%)
Balance Sheet	**2017**	**2018**	**2019f**	**2020f**
Net Loans and Advances	49.6	43.4	43.0	43.5
Government Securities	2.3	3.2	3.5	3.6
Other Assets	15.6	13.9	11.5	11.6
Total Assets	**67.5**	**60.5**	**58.1**	**58.7**
Customer Deposits	36.7	34.7	35.3	35.8
Other Liabilities	19.4	15.5	12.4	12.4
Total Liabilities	**56.1**	**50.2**	**47.7**	**48.2**
Shareholders Equity	11.4	10.4	10.4	10.1
Total Liabilities and Shareholders Equity	**67.5**	**60.5**	**58.1**	**58.7**
Book value Per share	5.0	24.3	24.3	23.6
% Change in BVPS		**391.8%**	**(0.1%)**	**(1.8%)**

Valuation Summary

HF Group is undervalued with a total potential return of -30.4%

Cost of Equity Assumptions:	29-Nov-19
Default Spread Adjusted Risk free rate	13.2%
Beta	1.20
Mature Market Risk Premium	7.6%
Extra Risk Premium	1.5%
Cost of Equity	24.2%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	22.0%
Return on Average Equity	7.0%
Terminal Price to Book	0.3x
Shareholder Equity - FY23e	10.7
Terminal Value-(Year 2023)	3.5

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	5.0	40%	2.0
Residual Income	(0.4)	35%	(0.1)
PTBV Multiple	9.8	20%	2.0
PE Multiple	7.4	5%	0.4
Fair Value			**4.2**
Current Price			**6.0**
Upside/(Downside)			(30.4%)
Dividend Yield			0.0%
Total return			***(30.4%)***

** Five years average yields on a 10 year Treasury bond*

Appendix

Feedback Summary

During the preparation of this Q3'2019 Banking Sector Report, we shared with the subject companies the operating metrics that were used in the Report for their confirmation and verification

- Below is a summary of the banks we were able to acquire feedback from and those that went unresponsive

Bank	Operating Metrics Shared	Sent Feedback
Co-operative Bank of Kenya	Yes	Yes
I&M Holdings	Yes	Yes
KCB Group	Yes	Unresponsive
Standard Chartered Bank Kenya	Yes	Unresponsive
NIC Group	Yes	Unresponsive
Diamond Trust Bank	Yes	Unresponsive
Housing Finance Group	Yes	Unresponsive
Stanbic Holdings	Yes	Unresponsive
Equity Group Holdings	Yes	Unresponsive
Barclays Bank of Kenya	Yes	Unresponsive
National Bank of Kenya	Yes	Unresponsive

Thank You!

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For more information or any further clarification required, kindly contact the research team at investment@cytonn.com

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