Kenya Listed Commercial Banks Analysis

Cytonn H1'2018 Banking Sector Report

"Growth and Efficiency Aided by Technology, Amid Deteriorating Asset Quality"

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Cytonn INVESTMENTS

I. Overview of the Firm

What We Stand For

Our Mission

We deliver innovative &differentiated financial solutions that speak to our clients' needs

Our Vision

To be Africa's leading investment manager by consistently exceeding clients' expectations

Our Values

People
Passionate and self-driven people who thrive in a team context

Excellence
Delivering the best at all times

Client Focus
Putting clients' interest first at all times

Entrepreneurship
Using innovation and creativity to deliver differentiated financial solutions

Accountability
We take both corporate and personal responsibility for our actions

Integrity
Doing the right things

Strategy is straightforward – just pick a general direction and implement like hell

— Jack Welch

About Us

Cytonn Investments is an alternative investment manager with presence in East Africa, Finland and the US. We provide investors with exposure to the high growth East Africa region. Our investors include global and local institutional investors, individual high net-worth investors and the diaspora.

82 Over Kshs. 82billion worth of projects under mandate	**7** Seven offices across 2continents	**500** Over 500 staff members	**10** 10 investment ready projects

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 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 CLIENTS SEGMENTS:

- High Net-worth Individuals through Cytonn Private Wealth
- East Africans in the Diaspora through Cytonn Diaspora
- Global and Local Institutional clients

WE INVEST OUR CLIENT FUNDS IN:

- Real Estate
- Private Equity
- Fixed Income Structured Solutions
- Equities Structured Solutions

We collect funds from our clients → **We invest them in high growth opportunities** → **We deliver the best possible returns**

Cytonn INVESTMENTS

Our Business

Where We Operate

Our Business Lines

Investments
Alternative investment manager focused on private equity and real estate

Real Estate
We develop institutional grade real estate projects for investors

Education
We provide exceptional learning experiences for individual and societal transformation

Hospitality
We operate an aspirational brand, which by consistently delivering exceptional service, ensure utmost client satisfaction

Asset Management
We offer collective investment schemes, fund management and real estate investments to global and local investors with the aim of generating above market average risk adjusted returns

Our People

If you could get all the people in an organization rowing the same direction, you could dominate any industry, in any market, against any competition, at any time.

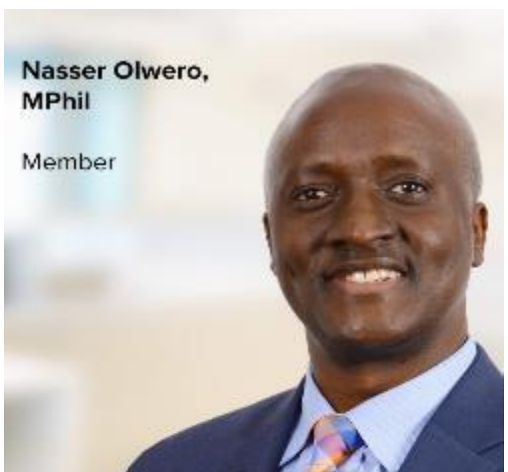
— Patrick Lencioni

We are focused on one agenda:

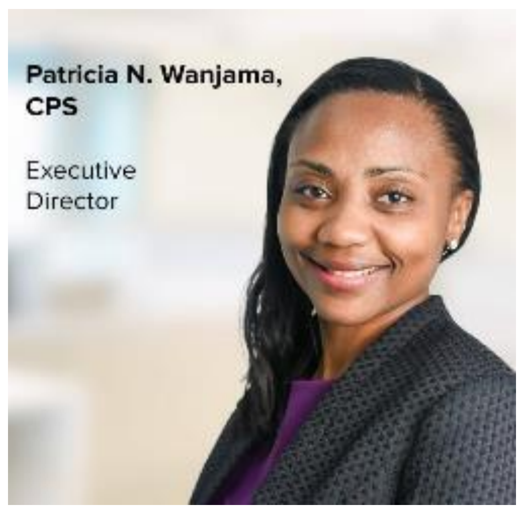
THE CLIENT

Board of Directors

To ensure that we remain focused on the clients' interests, we have put in place proper governance structures. We have a board of directors consisting of 11 members from diverse backgrounds, each bringing in unique skill-sets to the firm.



Board of Directors, Continued…



Governance Committees

We have four main board committees to ensure all of Cytonn's functions are done in a fair and transparent manner:

Investments and Strategy Committee

The committee oversees and provides strategic investment direction, including the implementation and monitoring process. The members are:-

- James Maina (Chair)
- Antti-Jussi Ahveninen, MSc
- Madhav Bhalla, LLB
- Edwin H. Dande, MBA
- Elizabeth Nkukuu

Audit, Risk and Compliance Committee

The committee establishes and oversees risk and compliance, including the implementation and monitoring process. The members are:-

- Madhav Bhalla, LLB (Chair)
- Nasser Olwero, Mphil
- Madhav Bhandari, MBA
- Patricia N. Wanjama, CPS

Governance, Human Resources and Compensation Committee

The committee establishes, oversees and implements governance structure, human resource policies and firm wide compensations. The members are:-

- Antti-Jussi Ahveninen, MSc (Chair)
- Prof. Daniel Mugendi Njiru, PhD
- Michael Bristow, MSc
- Edwin H. Dande, MBA

Technology and Innovation Committee

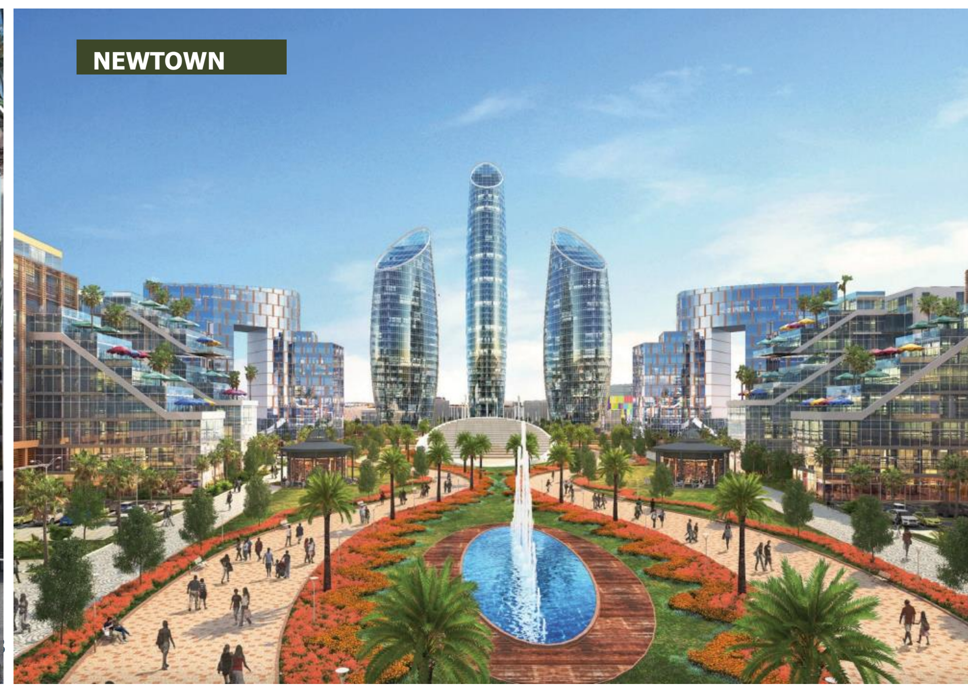
The committee establishes, oversees and implements technical expertise and innovative processes as a driver towards competitiveness. The members are:-

- Nasser Olwero, MPhil (Chair)
- Michael Bristow, MSc
- Patricia N. Wanjama, CPS

AMARA RIDGE

SITU VILLAGE

THE ALMA



NEWTOWN

II. Kenya Economic Review and Outlook

Kenya Economic Review

Of the 7 indicators we track, 5 are positive and 2 are neutral. We maintain our positive outlook on the 2018 macroeconomic environment

Key Macro-Economic Indicators – Kenya					
Indicators	**Expectations at start of FY'2018/2019**	**YTD 2018 Experience**	**Going forward**	**Outlook-Beginning of Year**	**Current Outlook**
GDP Growth	GDP growth for 2018 to improve to between 5.4% - 5.6% , from 4.9% recorded in 2017	Kenya's economy grew by 5.7% in Q1'2018, higher than 4.8% in Q1'2017. The consensus GDP growth projection for Kenya in 2018 is at 5.5% (an average taken from 14 research firms, global agencies and government organizations projections)	We maintain our GDP growth projection for 2018 at between 5.4%-5.6%, higher than 4.9% in 2017, and in line with the 5-year historical average of 5.4% driven by recovery of growth in the agriculture sector, continued growth in the tourism, real estate and construction sectors, and growth in the manufacturing sector	**Positive**	**Positive**
Interest Rates	A stable outlook on interest rates in 2018 with the CBR maintained at 9.5%	The Monetary Policy Committee (MPC) reduced the Central Bank Rate (CBR) for the 2nd time this year to 9.0% from 9.5% on their meeting held on 30th July 2018, citing that economic output was still below its potential despite improving economic growth prospects	The interest rate environment is expected to remain relatively stable, with the CBK not accepting high yields on treasury securities with the CBR rate having been lowered twice and with the interest rate cap still in place	**Neutral**	**Neutral**
Inflation	To average above the government annual target of between 2.5% - 7.5% in 2018	Inflation has averaged 4.2% in the first 8 months of 2018. The year on year inflation rate for the month of August declined to 4.0% from 4.4% in July, driven by a decline in food prices. However, m/m inflation rose by 0.3% due to increases in housing, water, electricity ,gas and other fuels index, coupled with an increase in the transport index.	Inflation in H2'2018 is expected to experience upward pressure due to the various tax amendments as per the Finance Bill 2018, but at a lower rate than earlier anticipated following the reduction of the VAT charge on fuel to 8.0% from 16.0% effective 21st September 2018, affirming our expectations on inflation for the year averaging within the government's set target of 2.5%-7.5%	**Positive**	**Positive**

Kenya Economic Review, continued…

Of the 7 indicators we track, 5 are positive and 2 are neutral. We maintain our positive outlook on the 2018 macroeconomic environment

Key Macro-Economic Indicators – Kenya					
Indicators	**Expectations at start of FY'2018/2019**	**YTD 2018 Experience**	**Going forward**	**Outlook-Beginning of Year**	**Current Outlook**
Currency	To remain stable supported by dollar reserves	The Shilling has appreciated by 1.9% against the USD YTD to 100.8 The current account deficit narrowed to 5.8% of GDP in the 12 months to June 2018 from 6.3% in March 2018. It is expected to narrow further to 5.4% of GDP in 2018, with strong growth of agricultural exports particularly tea and horticulture, resilient diaspora remittances, and improved tourism receipts	We expect the Kenyan Shilling to remain relatively stable against the dollar, supported by (i) Stronger inflows from principal exports, which include coffee, tea, and horticulture, which increased by 10.8% during the month of May to Kshs 24.3 bn from Kshs 21.9 bn in April (ii) improving diaspora remittances which increased by 71.9% by 4.9% m/m, from USD 253.7 mn in May 2018 , and (iii) the ample forex reserves currently at USD 8.6 bn (equivalent to 5.7 months of import cover).	**Neutral**	**Neutral**
Corporate Earnings	Corporate earnings growth of 8.0% in 2017 due to lower earnings for commercial banks attributed to the cap on interest rates	Listed Banks have recorded a weighted average increase in core EPS of 19.0% in H1'2018	We expect corporate earnings to improve in 2018, driven by improved macro economic fundamental evidenced by the GDP in Q1'2018 having expanded by 5.7% as well as resilience in the private sector with Kenya's Stanbic PMI having averaged 54.8 in the 7 months to August 2018 compared to 49.5 in a similar period in 2017 indicating improvements in the business environment	**Positive**	**Positive**

Kenya Economic Review, continued…

Of the 7 indicators we track, 5 are positive and 2 are neutral. We maintain our positive outlook on the 2018 macroeconomic environment

Key Macro-Economic Indicators – Kenya					
Indicators	**Expectations at start of FY'2018/2019**	**YTD 2018 Experience**	**Going forward**	**Outlook Beginning of Year**	**Current Outlook**
Investor Sentiments	Investor sentiment was expected to improve in 2018 given the now settling operating environment after conclusion of the 2017 elections	The Kenya Eurobond was 7.0x Oversubscribed, partly showing the appetite for Kenyan securities by the foreign community, and investor confidence in Kenya's stable and relatively diversified Economy. The yields on Kenyan Eurobonds however, have been fluctuating reflecting mixed investor sentiments	we still expect investor sentiment to improve in 2018 given; (i) the now settled operating environment after the conclusion of the long electioneering period in 2017, (ii) the expectation that long term investors will continue entering the market seeking to take advantage of the valuations which are still historically low, and (iii) expectations of a relatively stable shilling	**Positive**	**Positive**
Security	Security expected to be maintained in 2018, especially given the elections were concluded and the USA lifted its travel warning for Kenya, placing it in the 2nd highest tier of its new 4-level advisory program, indicating positive sentiments on security from the international community	The political climate in the country has eased, with security maintained and business picking up. The hand shake between the president and the opposition leader served to calm any political tension. Kenya now has direct flights to and from the USA, a possible sign of improving security in the country	We expect security to be maintained in 2018, especially given that there is relative calm, as the two principals work together towards combating corruption and promoting economic transformation agenda	**Positive**	**Positive**

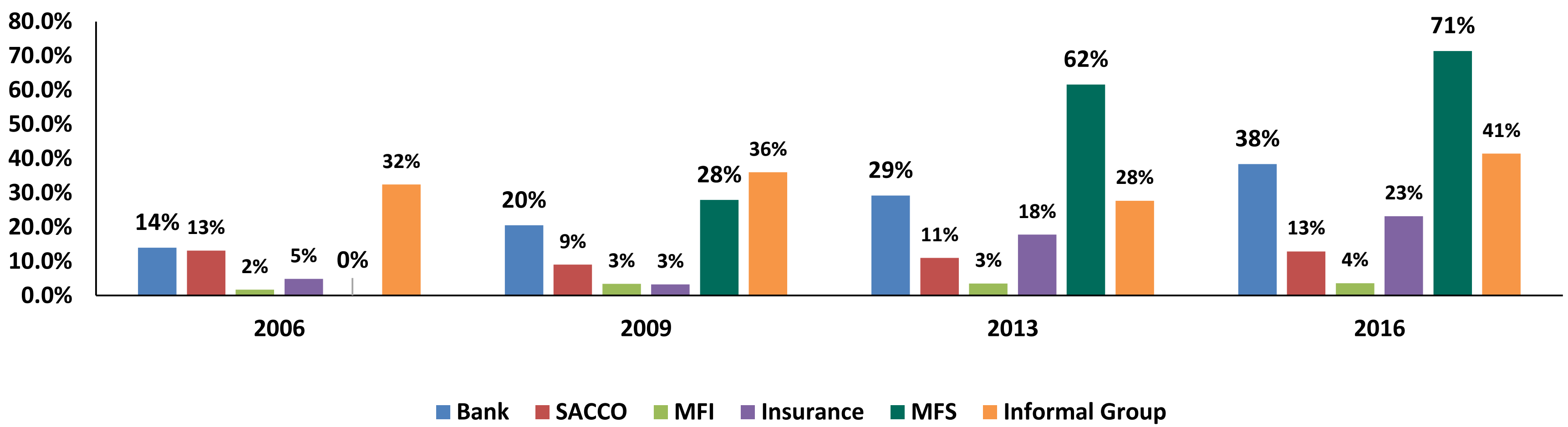
III. Kenya Banking Sector Overview

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 40 commercial banks, with Charterhouse Bank under statutory management and Imperial Bank under receivership, 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 the percentage of the population living within 3 kilometers of a financial services access point rising to 77.0% in 2017 from 59.0% in 2013. This has been driven by digitization, with Mobile Financial Services (MFS) rising to be the preferred method to access financial services in 2016

Use of Financial Service Providers over the Years



Source: Central Bank of Kenya

Kenya Banking Sector Overview, continued…

The sector has witnessed several acquisitions over the past 5-years. In 2018, SBM Bank Kenya acquired certain assets and liabilities of Chase Bank Ltd, which was under receivership

- Kenya's banking environment has been going through consolidation as evidenced by heightened M&A activity over the last 4 years. During H1'2018, SBM Bank Kenya Ltd completed the acquisition of certain assets and liabilities of Chase Bank Limited, which was under receivership. 75% of the value of all moratorium deposits at Chase Bank were transferred to SBM Bank Kenya. The remaining 25% will remain with Chase bank Limited under Receivership (CBLR). However, the full transaction value is yet to be disclosed
- 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
SBM bank Kenya	Chase Bank ltd	Unknown	75.0%	Undisclosed	**N/A**	Aug-18
Diamond Trust Bank Kenya	Habib Bank Limited Kenya	2.38	100.0%	1.82	**0.8x**	Mar-17
SBM Holdings	Fidelity Commercial Bank	1.75	100.0%	2.75	**1.6x**	Nov-16
M Bank	Oriental Commercial Bank	1.80	51.0%	1.30	**1.4x**	Jun-16
I&M Holdings	Giro Commercial Bank	2.95	100.0%	5.00	**1.7x**	Jun-16
Mwalimu SACCO	Equatorial Commercial Bank	1.15	75.0%	2.60	**2.3x**	Mar-15
Centum	K-Rep Bank	2.08	66.0%	2.50	**1.8x**	Jul-14
GT Bank	Fina Bank Group	3.86	70.0%	8.60	**3.2x**	Nov-13
Average			**80.3%**		**1.8x**	

- It is notable that acquisitions are also happening at much cheaper valuation compared to earlier bank acquisitions for example Fina, K-Rep and Equatorial Commercial Bank having been at 3.2x, 1.8x and 2.3x P/B, respectively, while recent acquisitions are happening at between 0 .8x to 1.7x P/B, and hence it is a great time to be an acquirer

Growth in the Banking Sector

Listed bank's H1'2018 EPS increased by 19.0% y/y from an average decline of 14.4% witnessed in H1'2017

- Kenya's listed banks recorded a positive EPS growth of 19.0% in H1'2018, compared to a 14.4% decline in H1'2017
- The increase was on the back of a 6.4% increase in Net Interest Income (NII) coupled with a 6.9% growth in Non-Funded Income (NFI) as banks adapted to operating under the interest rate cap regime. The Net Interest Margin (NIM) increased slightly to 8.1% in H1'2018 from 8.0% in H1'2017
- The sector had an improved efficiency as the Cost to Income Ratio improved to 55.7% from 59.2% in H1'2017, amid cost rationalization measure such as branch closures and staff layoffs in voluntary retirement plans
- Listed banks recorded a slow net loans and advances growth of 2.4% y/y to Kshs 1.94 tn in H1'2018 from Kshs 1.90 tn in H1'2017. Deposits grew at a faster growth 10.0% y/y to Kshs 2.5 tn in H1'2018 from Kshs 2.3 tn in H1'2017
- The sector had an improved profitability y/y, as shown by the rise in the Return on Average Equity (ROaE) to 19.5% from 17.9% in H1'2017

Banking Sector Growth Drivers

Alternative channels of transactions, operational efficiency and revenue diversification are the key growth drivers for banks

1) **Increased adoption of technology to improve efficiency:** 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 the number of transactions via alternative channels exceed those of bank branches, with the branches reduced to handling high value transactions and other services such as advisory. Thus banks reduced front-office operations, thereby reducing the staff required and by extension reducing operating expenses and hence improving operational efficiency
2) **Diversification to different revenue streams:** Banks have continued to diversify their revenue sources, as they adapt to operating under the interest rate cap regime. Banks increased the fees and commissions on loans and ventured into various NFI growth ventures such banc assurance. NFI was also earned from transactional income obtained as the number of transactions increased buoyed by increased adoption of alternative channels of transactions, with the average increase at 6.9% y/y from 5.1% in H1'2017
3) **Economic recovery:** The ongoing economic recovery will lead to improved demand for credit from sectors affected by the economic slump witnessed in 2017 due to political uncertainty and severe drought. Increased credit extended to sectors such as agriculture, real estate, manufacturing and trading presents interest income growth opportunities

Recent Developments in the Banking Sector

The Draft Financial Markets Conduct Bill is expected to address causal factors of low private sector credit growth and regulate financial conduct of industry participants

1. **Draft Financial Markets Conduct Bill 2018:** The National Treasury completed the Draft Financial Markets Conduct Bill, that seeks to create an effective financial consumer protection, make credit more accessible and consequently support financial innovation and competition. The bill's main objectives thus are:
    i. Ensure better conduct by banks and other lenders in terms of extending credit to retail financial customers. By categorically not defining lenders as banks, this, in our view, might be the introduction of licensing for credit companies that are not banks, mainly the non-deposit taking Microfinance Institutions (MFIs),
    ii. Provide consumer protection, mainly for retail customers by ensuring their credit contracts are clear and well understood in terms of interest, fees, charges and costs on credit facilities, thereby removing the opacity that has been existent in loan pricing
2. **Banking Sector Charter:** The Central Bank of Kenya proposed to introduce a Banking Sector Charter that will guide service provision in the sector. The Charter aims to instill discipline in the banking sector in order to make it responsive to the needs of the banked population. It is expected to facilitate a market-driven transformation of the Kenyan banking sector, thereby considerably improving the quality of service provided, and increasing access to affordable financial services for the unbanked and under-served population

Recent Developments in the Banking Sector Continued

The National Assembly voted to retain the 4.0% cap on loans, included in the Finance Bill

3. The National Assembly Voting to Retain 4.0% Cap on loans: Plans to repeal the Banking (Amendment) Act 2015 were dealt a blow, with a majority of the members of The National Assembly voting to retain the law, whose repeal proposition was included in the Finance Bill. The proposition to remove the floor of 70.0% of the CBR on deposits was included in the Finance Bill, which was passed, in a move that is set to see banks reduce interest payable on deposit, thereby possibly alleviating the reduced Net Interest Margins (NIMs) that came with the law

4. IFRS 9 Implementation: With the implementation of IFRS 9, which took effect from 1st January 2018, banks total capital position relative to their risk-weighted assets declined by an average of 0.4%. The implementation of IFRS 9 forced banks to review their business models, strategic objectives and credit policies. Thus banks adopted more stringent lending policies, and as a consequence lending was skewed towards collateral based lending as opposed to unsecured lending. To avoid the high provisioning levels that would be required, banks unwillingness to lend to the private sector and more specifically to SMEs is likely to persist

5. Large Cash Transactions Restrictions by Kenya Bankers Association: The KBA, in a circular, directed bank managers to ensure customers also provide supporting evidence for their source of cash when depositing and its use while withdrawing. Bank customers planning to withdraw or deposit Kshs 10.0 mn and above in cash will now be required to give a three-days' notice and get clearance from their respective branch managers

Recent Developments in the Banking Sector, continued…

The National Assembly voted to retain the 4.0% cap on loans, included in the Finance Bill

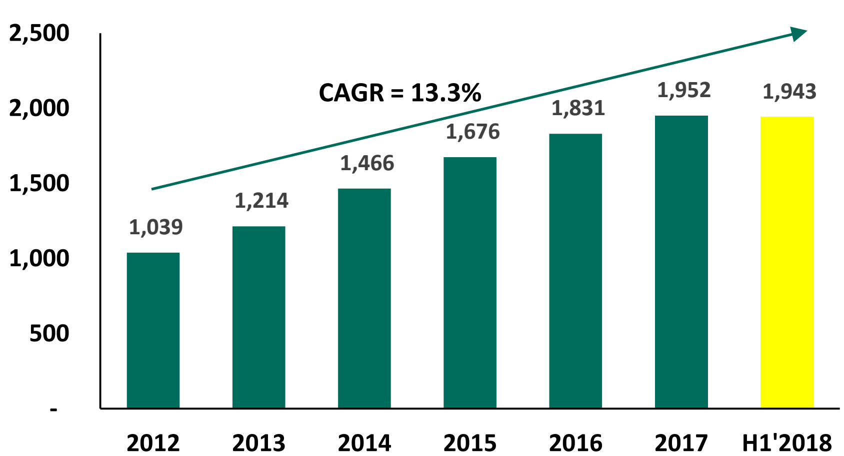
6. Loans to banks by international organizations for private sector and SME lending – Banks have been obtaining finance from international institutions mainly for onward lending to the private sector and SMEs, so as to plug a funding deficit occasioned by a mismatch in their assets and liabilities by tenor, as deposits tend to be relatively short term while loans are relatively long term. The funding issues so far have been summarized in the table below:

	Issuer	Bank	Issue Date	Amount of Loan (Kshs bn)	Term of Credit
1	IFC	Cooperative Bank	Feb-18	15.2	7-years
2	Africa Development Bank	Kenya Commercial Bank	Oct-17	10.4	Not specified
3	SwedFund	Victoria Commercial Bank	Apr-18	0.5	Not specified
4	14 financial Institutions (syndicated)	Stanbic Bank	May-18	10	2,3 years
5	Africa Development Bank	Diamond Trust bank	Mar-18	7.5	7-years
6	IFC	I&M Holdings	Jan-18	1	Not specified
	Total			**44.6**	

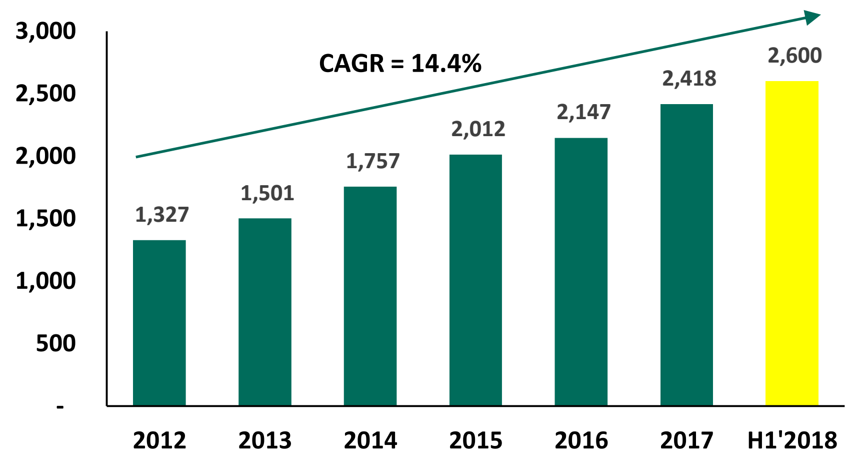
Listed Banking Sector Metrics

Deposit growth remains strong, coming in close to the historical average. Loan growth and branch opening slows down as private sector credit growth slumps and banks embrace alternative distribution channels

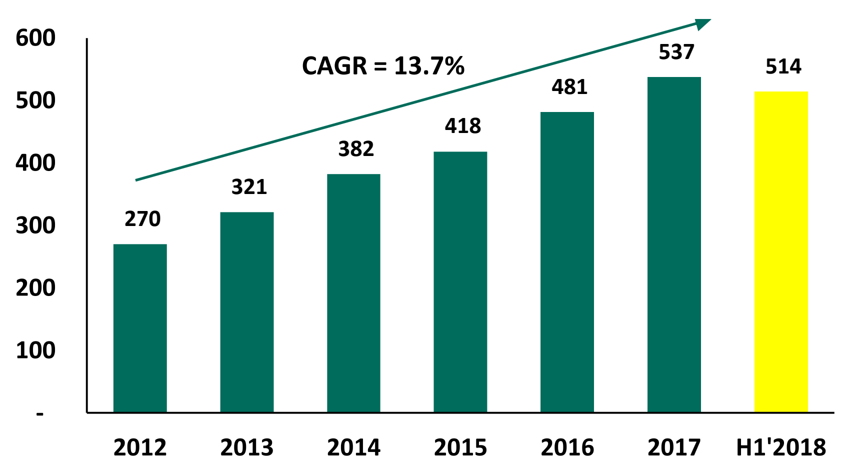
Loans and Advances (Kshs Bn)



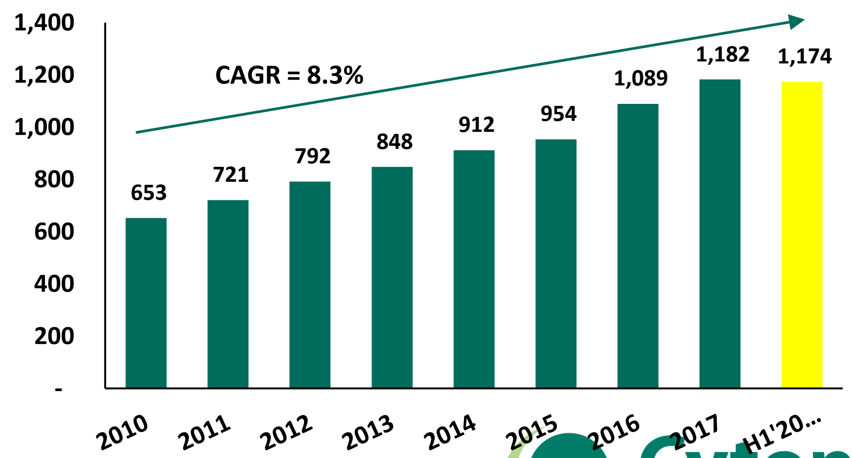
Deposits (Kshs Bn)



Shareholders Equity (Kshs Bn)



Bank Branches



Source: Central Bank of Kenya

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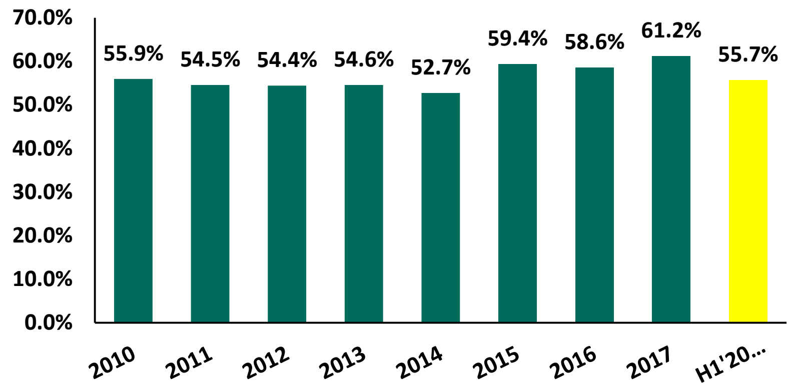
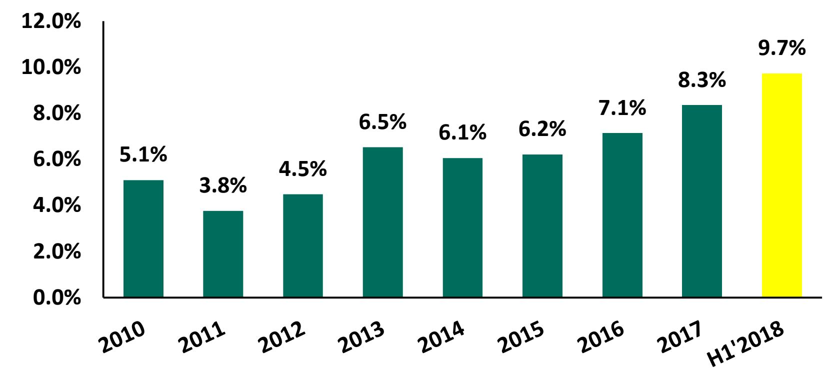
Listed Banking Sector Metrics, continued…

Under the regulated loan pricing framework, we have seen reduced lending, a decline in net interest margins, and higher levels of NPLs.

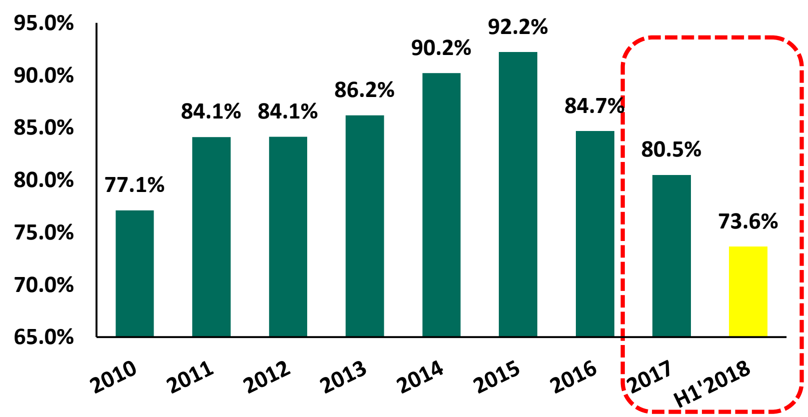
Cost to Income - with LLP (%)



NPLs to Total Loans (%)

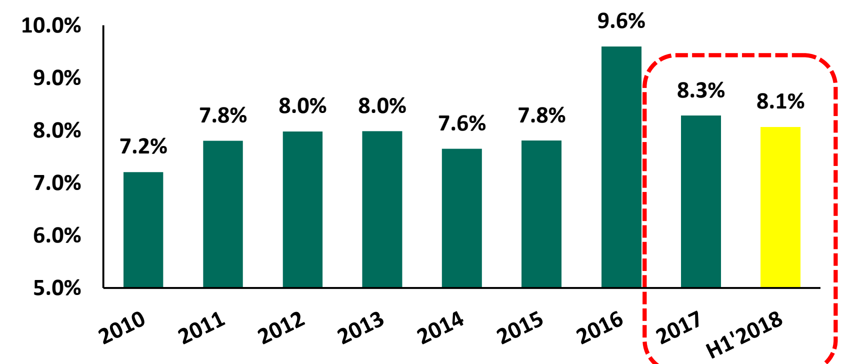


Loan to Deposits (%)



- The LDR has declined to 73.6% in H1’2018 from 80.5% in FY’2017, with banks adopting a more prudent credit risk assessment framework to ensure quality loan books

Net Interest Margin (%)



- Bank’s NIMs have declined marginally to 8.1% from 8.3% in 2017, following the capping of interest rates, and this has affected interest income of banks as the current regulatory framework has compressed margins

Source: Central Bank of Kenya

Cytonn INVESTMENTS

Listed Banks H1'2018 Earnings & Growth Metrics

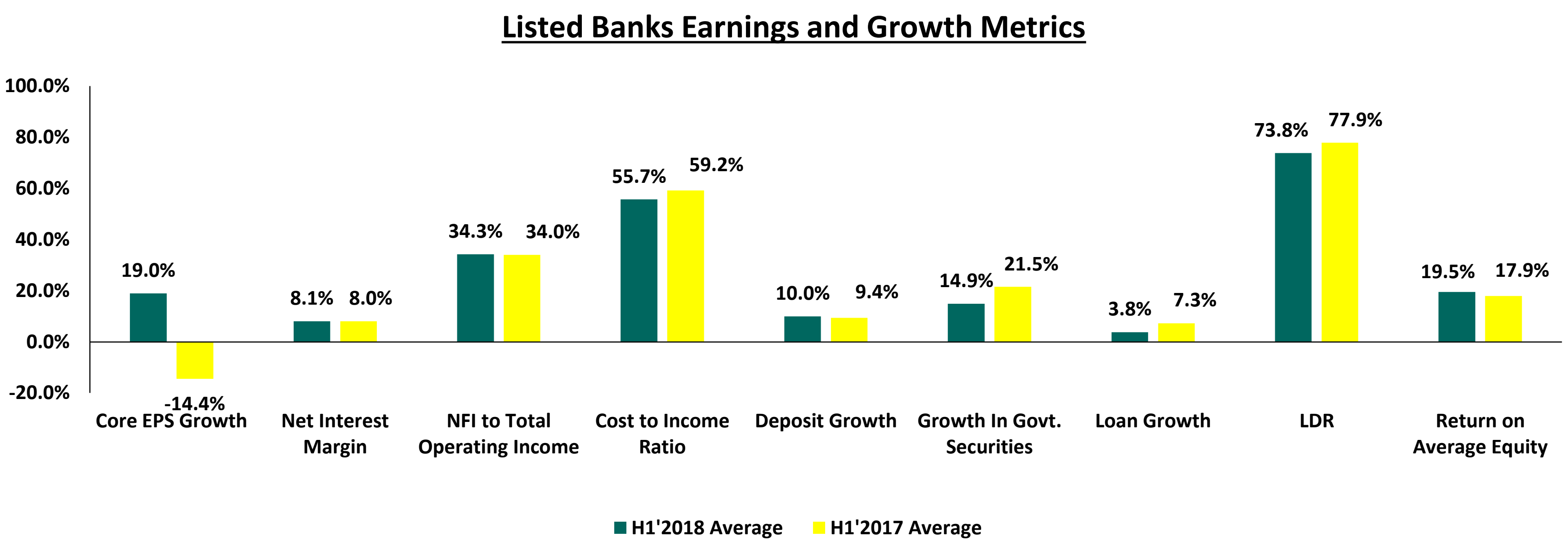
Kenya's listed banking sector H1'2018 core EPS increased by 19.0% compared to a decline of 14.1% in H1'2017 and consequently the ROaE also improved to 19.5% from 17.9%

Bank	Core EPS Growth	Net Interest Margin	NFI to Total Operating Income	Deposit Growth	Growth In Govt. Securities	Loan Growth	LDR	Return on Average Equity
CFC Stanbic	104.5%	4.9%	50.0%	21.3%	26.9%	15.4%	71.4%	14.8%
National Bank	39.3%	6.9%	28.8%	(2.8%)	9.8%	(16.1%)	49.8%	(0.6%)
Standard Chartered	30.3%	8.0%	32.9%	2.8%	3.5%	(1.1%)	48.4%	18.0%
KCB Group	18.0%	8.6%	32.2%	8.7%	8.7%	3.6%	80.3%	21.9%
Equity Group	17.6%	8.8%	40.2%	8.5%	18.7%	3.8%	69.9%	23.9%
I&M holdings	11.7%	7.1%	35.1%	30.6%	(8.0%)	12.6%	77.2%	17.2%
Co-op Bank	7.6%	8.6%	32.1%	3.9%	12.0%	(0.6%)	84.6%	18.0%
Barclays Bank	6.2%	9.0%	30.0%	14.9%	33.6%	7.5%	81.2%	17.5%
DTB	2.5%	6.5%	21.6%	9.9%	22.5%	3.5%	70.4%	15.5%
NIC Group	(2.1%)	6.0%	29.5%	10.5%	25.7%	(1.5%)	78.2%	12.8%
Housing Finance	(95.7%)	4.9%	30.4%	(3.1%)	17.3%	(9.8%)	131.4%	(0.2%)
H1'2018 Average	**19.0%**	**8.1%**	**34.3%**	**10.0%**	**14.9%**	**3.8%**	**73.8%**	**19.5%**
H1'2017 Average	**(14.4%)**	**8.0%**	**34.0%**	**9.4%**	**21.5%**	**7.3%**	**77.9%**	**17.9%**

** The weighted average is based on Market Cap as at 31st August, 2018*

Cytonn INVESTMENTS

Listed Banks H1'2018 Earnings & Growth Metrics…Continued



- The listed banks recorded a 19.0% increase in core EPS, compared to a decline of 14.4% in H1'2017, as a result of improved efficiency, with the Cost to Income Ratio improving to 55.7% from 59.2% in H1'2017, as cost rationalization measures bear fruit, coupled with recovery in interest income as NII grew by 6.4% compared to a 6.9% decline in 2017
- The LDR has declined to 73.6% from 77.9% in H1'2017, with banks now channeling funds more actively towards government securities, as loan growth came in at 3.8% a decline from a 7.3% increase in H1'2017. Deposit growth remained strong at 10.0%, slightly faster than 9.4% growth in H1'2017

** The weighted average is based on Market Cap as at 31st August, 2018*

Listed Banks H1'2018 Operating Metrics

Kenya's banking sector H1'2018 ROACE is at 19.5%, with the Cost to Income ratio of 55.6%

Bank	LDR	CIR	ROACE	Deposit/Branch	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio
Coop Bank	84.6%	54.9%	18.0%	1.9	10.9%	31.0%	16.8%
KCB Group	80.3%	52.0%	21.9%	2.0	8.4%	63.6%	14.4%
DTBK	70.4%	57.4%	15.5%	2.0	7.1%	70.7%	13.0%
Equity Bank	69.9%	52.8%	23.9%	1.4	8.5%	51.8%	14.7%
I&M Holdings	77.2%	53.7%	17.2%	5.0	13.0%	43.4%	14.7%
NIC Bank	78.2%	60.9%	12.8%	3.0	13.1%	52.2%	13.6%
Barclays Bank	81.2%	66.3%	17.5%	2.4	7.7%	68.2%	12.6%
SCBK	48.4%	55.2%	18.0%	6.6	14.8%	75.0%	14.5%
Stanbic Holdings	71.4%	54.0%	14.8%	8.3	6.6%	51.5%	11.8%
HF Group	91.1%	99.3%	(0.2%)	1.5	17.4%	39.0%	15.7%
NBK	49.8%	95.6%	(0.6%)	1.4	46.5%	56.5%	4.1%
Weighted Average H1'2018	73.8%	55.6%	19.5%	2.9	10.0%	55.9%	14.4%

** The weighted average is based on Market Cap as at 31st August, 2018*

Listed Banking Sector Multiples

Kenya's banking sector is currently trading at an average PTBV of 1.4x and a P/E of 6.8x

Bank	No. of shares (bn)	Market cap	P/E	Price**	P/TBV	Dividend Yield
HF Group	0.4	2.6	**2.4x**	6.8	**0.3x**	5.2%
NBK	0.3	1.8	**3.2x**	5.3	**0.4x**	0.0%
NIC Bank	0.7	19.7	**4.8x**	28	**0.7x**	3.6%
DTBK	0.3	48.9	**7.5x**	175	**1.0x**	1.5%
I&M Holdings	0.4	39.3	**5.3x**	95	**1.0x**	3.7%
Stanbic Holdings	0.4	37.8	**6.2x**	95.5	**1.2x**	5.5%
Coop Bank	5.9	86.2	**7.2x**	14.7	**1.3x**	5.4%
KCB Group	3.1	121.9	**5.7x**	39.8	**1.3x**	7.5%
Barclays Bank	5.4	54.3	**7.6x**	10	**1.4x**	9.7%
SCBK	0.3	68	**8.6x**	198	**1.6x**	8.6%
Equity Bank	3.8	150.9	**7.3x**	40	**1.9x**	5.0%
H1'2018* Weighted Average			**6.8x**		**1.4x**	**5.9%**

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

**Market cap as at 31/08/2018*

*** prices as at 19/09/2018*

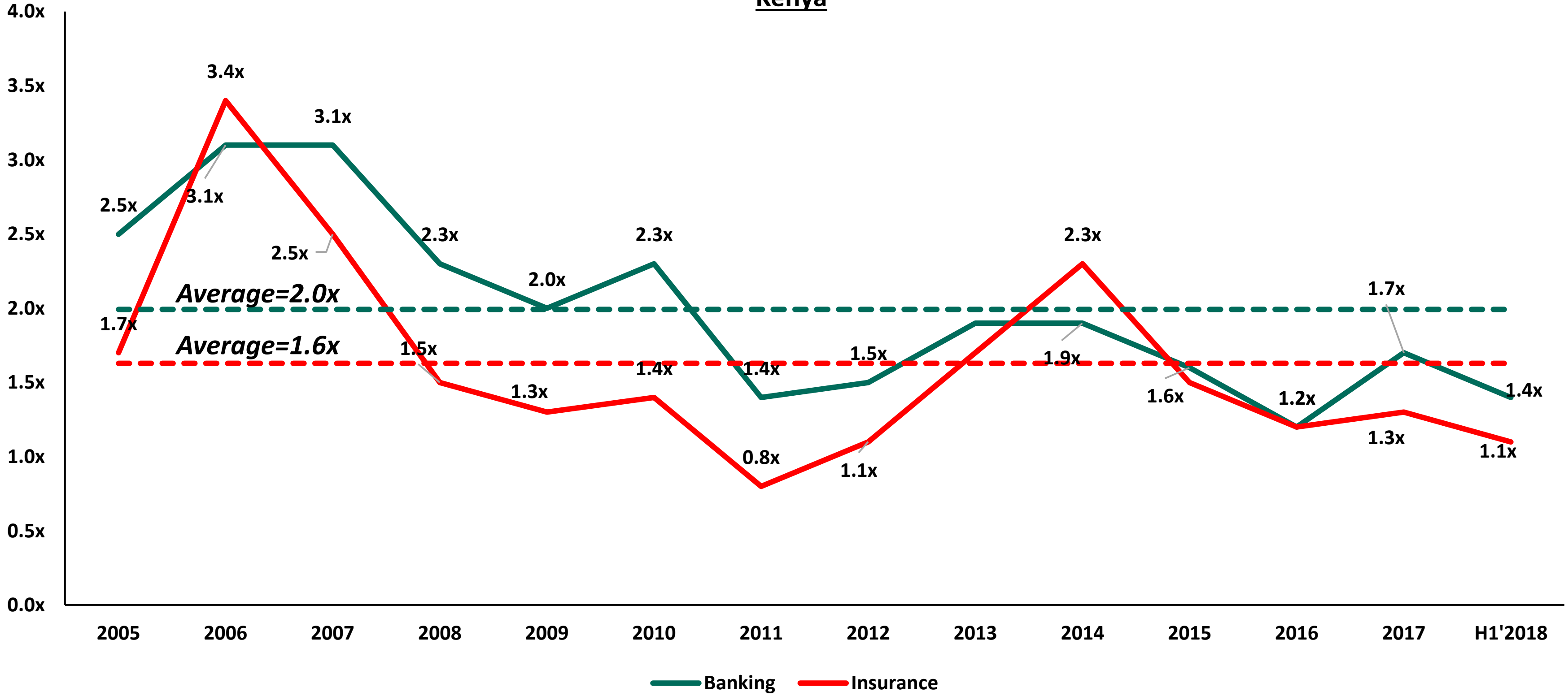
All values in Kshs unless stated otherwise

Source: NSE, Cytonn Banking Sector Report

Banking Sector Multiples

Listed Banks are currently priced at a PBV of 1.4x, higher than the listed insurance sector at 1.1x

13 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 1.1x, with both lower than their historical averages of 2.0x for the banking sector and 1.6x for the insurance sector

Source – Cytonn Research

Summary of the H1'2018 Earnings

Banks have adapted to the regulatory environment following capping of interest rates, with the sector recording a 19.0% increase in core EPS, compared to a decline of 14.4% in H1'2017

1. The market cap-weighted increase of 19.0% in core earnings in H1'2018 compared to a market cap weighted decline of 14.4% in H1'2017 shows that banks are adapting to the regulatory environment after the legislation capping interest rates was passed in the second half of 2016, with the shift in business models bearing fruit, as Non-funded revenue expansion and cost rationalization strategies taking effect
2. Deposits grew at a faster rate than loans at 10.0% compared to loans at 3.8%, Slower than 7.3% recorded in H1'2017, indicating reduced intermediation between depositors and credit consumers, with the loan to deposit ratio declining to 73.8% from 77.9% in H1'2017
3. The level of NPLs remains a concern within the banking sector with the weighted average gross non-performing loan (NPL) ratio for the listed banks rising to 10.0%, from 7.7% in H1'2017. We expect the level of provisioning to increase going forward as banks continue adopt IFRS 9 that requires a forward looking approach to estimate credit losses, coupled with increased provisioning for the deteriorating financial assets

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IV. Cytonn's Banking Sector Report

Executive Summary

Cytonn has undertaken this report to offer our investors a comprehensive view of the listed banks

- All listed banks in the Kenyan market were analysed by the Cytonn Investment Team
- The analysis was brought about by a need to be able to take a view on the banking sector to determine which banks are the most stable from a franchise value and from a future growth opportunity perspective
- The analysis covers the health and future expected performance of the financial institution, by highlighting their performance using metrics to measure profitability, efficiency, growth, asset quality, liquidity, revenue diversification, capitalization and intrinsic valuation
- The analysis was undertaken using H1'2018 results (franchise value) and analyst's projections of future performance of the banks (future growth opportunities)
- For banks which are part of a group structure, the financials of the group were utilised to take into consideration the listed counter which an investor will purchase
- The overall ranking was based on a weighted average ranking of Franchise value (accounting for 40%) and Intrinsic value (accounting for 60%)

Growth and Efficiency Aided by Technology, Amid Deteriorating Asset Quality

Focus Area	Summary	Effect on Banking Sector
Regulation	• **Price controls:** Put in place in the industry following the enactment of the Banking Act (Amendment) 2015 • **Transition to IFRS 9 from IAS 39:** IFRS 9 requires banks to adopt a forward looking approach in credit risk assessment	• Net Interest Margins declined due to the price controls, with the Net Interest Margin coming in at 8.1% from 8.3% in H1'2017, • Banks total capital position relative to their risky assets declined by an average of 0.4% on IFRS 9 implementation. lending policies, were skewed towards collateral based lending
Diversification	• **Increased diversification to non-funded income revenue streams:** With banks registering compressed net interest margins, much of the attention has shifted to non-funded income, as this section of the bank's revenue is not affected by the interest rate caps.	• Non-Funded Income growth has been emphasized in the new bank's business model, rising by 6.9% in H1'2018, from 5.1% in H1'2017, which has shored up banks income. Revenue expansion by product diversification is one of the core opportunities for the banking sector to achieve sustainable growth
Technology	• **Increased focus on digital banking:** With an increased proliferation of mobile banking technologies, banks have shifted focus towards development of online and digital channels of distribution of banking products and services	• Increased adoption of these alternative channels of distribution has had a two-fold effect to banks, by (i) improving operational efficiency via the reduction in staff and branch requirements and (ii) Increase NFI in the form transactional income , thus leading to improved CIR to 55.6% from 59.2% in H1'2018
Asset Quality	• **Increase in non-performing loans:** With the Gross NPL ratio currently at 10.0% from 7.7% in H1'2017, and much higher than the 5-year average of 8.4%. This raises concerns around asset quality in the sector	• The increased NPLs and adoption of IFRS 9 has forced banks to adopt prudent banking based on a more stringent risk assessment framework, to effectively reduce financial impairments and consequently the provisioning requirements required under the new reporting standard

Diversification proves to be key to growth in the Banking sector, in the wake of a tighter regulated environment, following the capping of interest rates and compliance to the IFRS 9 standard. Increased usage of alternative channels improves operational efficiency as well as expanding non-funded revenue. Deteriorating asset quality remains a concern, which has seen banks reduce lending to the riskier private sector and channel more funds to government securities, thus leading to reduced intermediation of depositors and credit consumers

Rankings by Franchise Value

KCB Group emerged top in the franchise value rankings, with HF Group coming last

Company	LDR	CIR	ROACE	NIM	PEG ratio	PTBV	Deposits/ Branch	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non Interest Income/ Revenue	Camel Rating	Corporate Governance	Score	H1'2018 Rank	Q1'2018 Rank
KCB Group	3	2	2	4	2	7	7	4	4	6	4	1	1	**47**	**1**	1
Equity Bank	9	3	1	2	1	11	10	5	7	3	2	2	5	**61**	**2**	1
Coop Bank	1	5	4	3	6	8	8	6	11	1	6	7	5	**71**	**3**	4
I&M Holdings	5	4	6	6	5	4	3	7	9	4	3	8	9	**73**	**4**	3
SCBK	11	6	3	5	10	10	2	9	1	5	5	5	3	**75**	**5**	8
Barclays Bank	2	9	5	1	11	9	5	3	3	9	8	3	8	**76**	**6**	4
Stanbic	7	1	8	10	9	6	1	1	8	10	1	4	10	**76**	**6**	7
DTBK	8	7	7	8	8	5	6	2	2	8	11	6	2	**80**	**8**	6
NIC Bank	4	8	9	9	7	3	4	8	6	7	9	9	4	**87**	**9**	9
NBK	10	10	10	7	4	2	11	11	5	11	7	10	5	**103**	**10**	11
HF Group	6	11	11	11	3	1	9	10	10	2	10	11	10	**105**	**11**	10

- The bank ranking assigns a value of 1 for the best performing bank, and a value of 11 for the worst
- The metrics highlighted a bank's profitability, efficiency, growth, asset quality, liquidity, revenue diversification, capitalization and soundness
- KCB Group Ranked 1st position. KCB Group's ranking was on the back of a low cost to income ratio of 52.0% compared to an industry average of 55.7%, a high ROACE of 21.9% compared to the industry average of 19.5% as well as having the best CAMEL rating and Corporate Governance scores
- HF ranked 11 owing to increased costs and low return, with the Cost to Income Ratios at 99.3% as compared to an industry average of 55.7%, low Net Interest Margin of 4.9% compared to the industry average of 8.1%, and Returns on average common equity of (0.2%) against the industry average of 19.5%

- **LDR- net Loan to Deposit Ratio*
- ***CIR-Cost to Income Ratio with Provisions*
- ****ROACE -Return on Average Common Equity*
- *****NIM - Net Interest Margin*

Source: Cytonn Research

Rankings by Intrinsic Value

NIC Group has the highest upside with a total potential return of 77.9%

Bank	Current Price*	Target Price	Upside	Dividend Yield	Total Potential Return	H1'2018 Ranking	Q1'2018 Ranking
NIC Bank	28.0	48.8	74.3%	3.6%	77.9%	**1**	1
DTBK	175.0	283.7	62.1%	1.5%	63.6%	**2**	2
KCB Group	39.8	61.3	54.1%	7.5%	61.7%	**3**	4
I&M Holdings	95.0	138.6	45.9%	3.7%	49.6%	**4**	3
Equity Bank	40.0	56.2	40.4%	5.0%	45.4%	**5**	8
Coop Bank	14.7	19.9	35.6%	5.4%	41.0%	**6**	7
Barclays Bank	10.0	12.5	25.0%	9.7%	34.7%	**7**	6
SCBK	198.0	196.3	(0.8%)	8.6%	7.7%	**8**	9
Stanbic Holdings	95.5	92.6	(3.0%)	5.5%	2.5%	**9**	10
HF Group	6.8	6.6	(2.9%)	5.2%	2.3%	**10**	5
NBK	5.3	4.9	(5.8%)	0.0%	(5.8%)	**11**	11

Prices as at 19st September 2018

- The Intrinsic Valuation is computed through a combination of valuation techniques, with a weighting of 75.0% on Discounted Cash flow Methods and 25.0% on Relative Valuation
- NIC Group has the highest upside at 77.9%, followed by DTBK and KCB Holdings at 63.6% and 61.7%, respectively
- Equity Group rose 3 positions to position 5 from 8 in Q1’2018, with an expected return of 45.4%

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Composite Bank Ranking

Overall, KCB Group ranked highest, while 7 banks shifted positions from Q1'2018

Bank	Franchise Value Total Score	Intrinsic Value Score	Weighted Score	H1'2018 Rank	Q1'2018 Rank
KCB Group	**47**	3	20.6	**1**	1
Equity Bank	**61**	5	27.4	**2**	2
I&M Holdings	**73**	4	31.6	**3**	3
Coop Bank	**71**	6	32.0	**4**	6
DTBK	**80**	2	33.2	**5**	4
Barclays Bank	**76**	7	34.6	**6**	5
SCBK	**75**	8	34.8	**7**	8
NIC Bank	**87**	1	35.4	**8**	8
Stanbic Holdings	**76**	9	35.8	**9**	7
NBK	**103**	11	47.8	**10**	11
HF Group	**105**	10	48.0	**11**	10

- In our ranking, franchise value was assigned a weighting of 40.0% while the intrinsic value was assigned 60.0% weight
- KCB Group maintained the 1st position, while Equity Group and I&M Holdings also maintained the 2nd and 3rd positions from Q1'2018
- Co-operative Bank rose 2 positions to position 4 from 6th in Q1'2018, while Stanbic Holdings declined 2 spots to position 9 from 7th in Q1'2018

Appendix

A. Metrics Used

Banking Sector Report – Metrics Used

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

1. **Net Interest Margin -** A bank's net interest margin (NIM), is the difference between the interest paid on deposits and the interest earned on loans, relative to the amount of interest-earning assets with higher net interest margins translating into higher profits

Output:

Majority of Bank's increased their allocation to government securities following the interest rate cap, as opposed to giving out more loans. Barclays Bank had the highest NIM at 9.0%, with the lowest for Stanbic Holdings and Housing Finance at 4.9%

2. Return on Average Common Equity - A bank's return on average common equity (ROACE), is the amount of profit the bank earns as a percentage of average common shareholders' equity. It's a profitability measure that shows how much a company generates with the money shareholders have invested

Output:

Banks with higher ROACEs are better at utilizing capital to generate profits. Equity Group has the highest ROACE at 23.9%, while National Bank had the lowest at (0.6)%

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

3. Price/Earnings to Growth Ratio - The price/earnings to growth (PEG) ratio is the stock's market price to earnings ratio divided by its growth in earnings for a specified period of time. The PEG ratio is used to determine the value of a stock while taking into account its growth rate, with lower PEG ratios showing the stock is undervalued given the growth in its earnings

Output:

To obtain this ratio, we estimated each bank's 5-year growth rate based on analysis of (i) bank's fundamentals, (ii) projections using each bank's models and (iii) management's input on a bank's strategy going forward. Equity Group had the lowest PEG ratio at 0.5x, while Barclays Bank was the most overvalued at 1.3x

4. Deposits per Branch - A bank's deposits per branch shows the amount of deposits a bank collects from each of its branches, hence a measure of efficiency. Banks with higher deposits per branch are preferred, as it shows for each unit cost of capital expenditure required to open new branches and their subsequent operating costs, a bank receives more in deposits

Output:

Stanbic Holdings has the highest deposits per branch at Kshs 8.3 bn, while NBK had the lowest deposits per branch at Kshs 1.4 bn

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

5. Loans to Deposits Ratio - A bank's loans to deposit ratio (LDR) is a measure of liquidity as it shows how much of a bank's loans are being funded by its deposits. Low LDR ratios indicate that the bank may not be earning a lot of interest. Very high LDR's indicate that the bank might not have enough liquidity to cover any unforeseen funding requirements, and ratios above 1 show that the bank supplemented their loan issues with outside borrowing

Output:

Taking a preferred LDR of 85.0%, we found that Cooperative Bank was closest to the target at 84.6%, while HF Group was the farthest at 131.4%

6. Cost to Income Ratio - The cost to income ratio is a measure of a bank's efficiency, showing its costs in relation to its income. A lower ratio is preferred, as it indicates a bank is more profitable. An increase in the ratio often highlights potential problems as it shows a bank's costs rose faster than its income; while a fall in the ratio could be brought by management's cost cutting measures

Output:

We see many Kenyan banks making an effort to be more efficient. Many banks have opted to restructure, and others have resorted to laying off staff in a bid to bring down costs and subsequently this ratio. Stanbic Holdings had the lowest cost to income ratio of 50.1%, while HF Group had the highest ratio at 99.3%

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

7. Price to Tangible Book Value - This is a valuation ratio that expresses the bank's market price to its tangible book value. It shows the price an investor would pay for a unit amount in the event of a liquidation. A ratio of less than one indicates that the bank's assets are undervalued in the market while a ratio greater than one signifies overvaluation

Output:

We found that HF Group was the most undervalued banks as per this metric at 0.3x, while Equity Group is the most overvalued at 1.9x

8. Tangible Common Equity Ratio - This is the ratio of a bank's common equity less intangible assets to its tangible assets. It is a common indicator of a bank's risk and capitalization and measures how much losses a bank can take before shareholder's equity is wiped out, hence solvency

Output:

Co-operative is the most solvent with a tangible common ratio of 16.8%, while NBK was the least solvent at 4.1%

9. Gross non-performing loans ratio - This is a measure of the percentage of a bank's issued loans that are non-performing that is, in default, or close to being in default

Output:

Stanbic Holdings had the highest quality loan book with a gross non-performing loans ratio of 6.6%, while NBK had the highest non-performing loans ratio at 46.5%

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

10. Non-Performing Loans Coverage - This is a credit quality metric that measures the credit risks for banks. It shows the extent to which the NPLs are covered by provisions hence the degree of stability of the bank's lending base, with higher ratios preferred

Output:

SCBK has the highest provisions for non-performing loans at 75.0%, while Co-operative Bank has the lowest at 31.0%

11. Non-Interest Income to Revenue - The non interest income is the income earned from sources other than loans and investments. The non-interest income to revenue therefore shows the extent of diversification of a bank's operations. High levels are preferred, not exceeding the point where the bank loses focus of its primary business

Output:

We see that Kenyan banks' non-interest income is set to benefit from new initiatives such as banc-assurance and mobile banking. Stanbic Holdings has the highest non-interest income as a percentage of revenue at 50.0%, while DTBK has the lowest at 21.6%

12. Camel Rating - This is a ranking system that assesses the overall condition of a bank, that is, Capital Adequacy, Asset Quality, Management Quality, Earnings Quality and Liquidity. We also incorporated a governance score in the ranking

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Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

13. Corporate Governance Score –This is a ranking system where we analyse 25 metrics to rank listed companies on their corporate governance. Main areas of analysis are in the board composition, audit functions, CEO tenor and evaluation, remuneration and transparency

Output:

The score assumes a diffusion index with 50.0% as the base. Anything below 50.0% should be flagged as having serious corporate governance issues while anything above is skewed towards proper governance. However the variance from 100.0% gives the risk associated with corporate governance

B. Tier I Banks

Tier 1 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
Equity Group	• The digitization strategy of the Bank, with the roll out of Eazzy Banking App and Equitel, which is currently the 2nd largest mobile money transfer service, coupled with good performance of regional subsidiaries	• Reduced Intermediation: Equity bank has reduced its lending considerably, having one of the lowest LDRs at 69.9%. • Reduced funded revenue may inhibit the banks growth if sustained for long periods of time
KCB Group	• KCB Mpesa, is expected to be a key growth driver in terms of deposits and loans • Alternative channels including mobile banking and agency banking	• The alternative channels seem not to generate revenue, with the bank having a slow 0.5% growth y/y in NFI in H1'2018
Co-op Bank	• It has a large Sacco banking base, and the opportunity to grow upon the model • Increased operational efficiency and cost reduction due to its recent transformation project	• The bank's asset quality has been deteriorating consistently for the last 3 quarters. With the deterioration not matched to provisioning, the bank had the worst loan coverage in the listed space
Standard Chartered	• Custody business will continue providing the bank with a niche when it comes to wholesale banking • Strong in corporate banking business	• High NPLs have affected their revenues but adoption of prudent screening criteria is bound to address this. Reduced lending by the bank negatively affects funded revenue, with the bank having the lowest LDR in the listed banking space

Tier 1 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
Barclays Bank	• The separation from Barclays Plc provides Barclays with more opportunities for growth, including venturing into other business lines, initially restricted by Barclays plc. • The launch of Timiza App, which gained 2.0 mn users and disbursed 800,000 loans in the first 130 days	• Stiff competition in the retail and SME banking market from the larger peers • The ongoing Rebranding exercise to absa will affect the bank's efficiency in the near term, given the costly nature of the process
DTB Bank	• Strong backing from financing partners, i.e. Aga Khan Fund for Economic Development and Habib bank • Partnerships with Jubilee Insurance and local retailers to drive Non-funded income • Increased branch network will help mobilize deposits from customers	• Stiff competition in the SME banking market from established players like Equity and KCB • Exposure to different political, economic and regulatory environments as a result of regional presence in East Africa
Stanbic Holdings	• The Corporate and Investment banking is a key driver for revenue as it contributes to a majority of the banks total income • Their mobile banking platform is set to reduce costs associated with branch transactions	• Their expansion strategy is limited by the presence of Standard Bank in the region • The bank seems to have high proportions of low yielding assets, with the bank having the second worst NIM

I. Equity Group

B. Tier I Banks

I. Equity Group

Financial Statements Extracts

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

Income Statement	2016	2017	2018e	2019e	2020e
Net Interest Income	41.8	38.4	41.2	46.4	52.1
Non Funded Income	22.2	23.1	29.1	32.1	36.7
Loan Loss Provision	6.6	7.1	3.5	4.3	6.3
Other Operating Expenses	32.5	31.1	34.9	38.0	41.7
Total Operating Expenses	**39.1**	**38.2**	**38.5**	**42.3**	**48.1**
Profit Before Tax	24.9	23.3	31.9	36.2	40.7
Profit After tax	16.5	18.9	22.4	25.4	28.5
% PAT Change YoY	**-4.5%**	**14.1%**	**18.5%**	**13.4%**	**12.5%**
EPS	4.4	5.0	5.9	6.7	7.6
DPS	2.0	2.0	2.0	2.5	2.8
Cost to Income	50.7%	58.7%	54.7%	53.9%	54.1%
NIM	11.1%	8.9%	8.4%	8.8%	8.8%
ROaE	21.5%	21.6%	26.0%	25.6%	24.1%
ROaA	3.7%	3.8%	4.3%	4.2%	4.2%

Balance Sheet	2016	2017	2018e	2019e	2020e
Net Loans and Advances	266.1	277.9	290.7	330.2	375.0
Government Securities	100.6	139.2	158.8	175.5	200.2
Other Assets	107.1	124.7	127.6	129.9	137.4
Total Assets	**473.7**	**541.7**	**577.0**	**635.6**	**712.6**
Customer Deposits	337.2	385.9	415.2	465.1	520.9
Other Liabilities	54.5	72.5	71.7	62.7	62.9
Total Liabilities	**391.7**	**458.4**	**486.9**	**527.7**	**583.8**
Shareholders Equity	82.0	83.3	90.1	107.9	128.8
Total Liabilities and Shareholders Equity	**473.7**	**541.7**	**577.0**	**635.6**	**712.6**

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Valuation Summary

Equity Group is undervalued with a total potential return of 45.4%

Cost of Equity Assumptions:	20-Sep-18
Default Spread Adjusted Risk free rate*	13.2%
Beta	1.26
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.8%
Cost of Equity	20.7%

Terminal Assumptions	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	19.17%
Return on Average Equity	21.8%
Terminal Price to Book value per share	1.2x
Shareholder Equity - FY21e	139.00
Terminal Value-(Year 2021)	172.90

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intergrated DDM	72.3	40.0%	28.9
Residual Income	56.4	35.0%	19.7
PBV Multiple	28.1	20.0%	5.6
PE Multiple	40.0	5.0%	2.0
Target Price			**56.2**
Current Price			**40.0**
Upside/(Downside)			40.4%
Dividend Yield			5.07%
Total Potential Return			**45.4%**

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

II. KCB Group

Financial Statements Extracts

KCB Group's PAT is expected to grow at a 5-year CAGR of 11.3%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	47.0	48.4	51.6	56.6	61.4
Non Funded Income	22.5	23.0	24.6	26.4	28.6
Loan Loss Provision	3.8	5.9	4.8	5.5	6.0
Other Operating Expenses	36.6	36.4	39.0	41.1	43.6
Total Operating Expenses	**40.4**	**42.3**	**43.8**	**46.7**	**49.6**
Profit Before Tax	29.1	29.1	32.4	36.2	40.5
Profit After tax	19.7	19.7	22.7	25.4	28.3
% PAT Change YoY	**0.5%**	**(0.1%)**	**14.9%**	**12.0%**	**11.7%**
EPS	6.4	6.4	7.4	8.3	9.2
DPS	3.0	3.0	3.5	4.0	4.4
Cost to Income	58.1%	59.2%	57.5%	56.3%	55.0%
ROE	22.2%	19.5%	20.4%	32.4%	26.2%
ROA	3.3%	3.0%	3.5%	5.7%	4.8%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	385.7	422.7	443.7	476.4	519.3
Government Securities	40.5	38.3	34.6	38.9	45.1
Other Assets	208.8	222.7	228.9	255.7	277.7
Total Assets	**635.0**	**683.6**	**707.2**	**771.0**	**842.2**
Customer Deposits	448.2	499.5	546.1	595.3	650.1
Other Liabilities	50.5	41.2	44.6	46.1	47.8
Total Liabilities	498.7	540.7	590.8	641.4	697.8
Shareholders Equity	96.6	106.0	116.4	129.6	144.3
Total Liabilities and Shareholders Equity	**635.0**	**683.6**	**707.2**	**771.0**	**842.2**

Valuation Summary

KCB Group is undervalued with a total potential return of 61.7%

Cost of Equity Assumptions:	20/09/2018
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.9
Market Risk Premium	5.2%
Cost of Equity	17.9%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	18.4%
Return on Average Equity 2022	18.6%
Terminal Price to Book value per share	1.5x
Shareholder Equity - FY22e	178.5
Terminal Value - (Year 2022)	281.2

Valuation Summary	Implied Price	Weighting	Weighted Value
Residual Income	60.1	35%	21.0
PBV Multiple	46.9	20%	9.4
PE Multiple	54.5	5%	2.7
DDM Integrated	70.6	40%	28.3
Target Price			**61.3**
Current Price			**39.8**
Upside/(Downside)			54,1%
Dividend Yield			7.5%
Total Return			**61.7%**

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

III. Co-operative Bank of Kenya

Financial Statements Extracts

Co-operative Bank's PAT is expected to grow at a 5-year CAGR of 11.2%

Income Statement	2016	2017	2018f	2019f	2020f
Net Interest Income	29.5	28.1	28.7	32.4	35.6
Non Funded Income	12.8	13.5	14.9	16.4	18.2
Loan Loss Provision	(2.6)	(3.6)	(3.9)	(4.6)	(5.1)
Other Operating Expenses	(22.0)	(21.7)	(22.2)	(25.5)	(28.1)
Total Operating Expenses	(24.6)	(25.3)	(26.2)	(30.1)	(33.2)
Profit Before Tax	17.7	16.4	17.55	18.79	20.67
Profit After tax	12.7	11.4	12.29	13.15	14.47
% PAT Change YoY	**8.3%**	**-10.2%**	**7.8%**	**7.0%**	**10.0%**
EPS	2.6	2.3	2.09	2.24	2.47
DPS	1	1	0.8	0.8	0.8
Cost to Income	58.3%	60.9%	60.0%	61.7%	61.7%
NIM	9.9%	8.8%	8.6%	8.4%	8.4%
ROE	22.7%	17.4%	18.9%	18.1%	17.9%
ROA	3.7%	3.1%	3.2%	3.0%	3.0%

Balance Sheet	2016	2017	2018f	2019f	2020f
Net Loans and Advances	236.9	253.9	270.92	303.76	339.37
Government Securities	61.9	72.7	86.96	88.71	99.33
Other Assets	53	60.31	68.04	68.24	68.67
Total Assets	**351.9**	**386.9**	**425.9**	**460.7**	**507.4**
Customer Deposits	279.8	287.4	312.00	349.44	389.62
Other Liabilities	10.9	29.2	44.88	34.33	35.30
Total Liabilities	**290.7**	**316.6**	**356.9**	**383.8**	**424.9**
Shareholders Equity	61.3	69.6	68.47	76.60	85.54
Total Liabilities and Shareholders Equity	**351.9**	**386.9**	**425.9**	**460.7**	**507.4**

Cytonn INVESTMENTS

Valuation Summary

Co-operative Bank is undervalued with a total potential return of 41.0%

Cost of Equity Assumptions:	9/20/2018
Default Spread Adjusted Risk free rate *	13.2%
Beta	0.90
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.8%
Cost of Equity	18.6%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	19.2%
Return on Average Equity 2022	19.0%
Terminal Price to Book value per share	1.5x
Shareholder Equity - FY22e	107.8
Terminal Value-(Year 2022)	169.8

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	23.13	40%	9.25
Residual income	18.90	35%	6.62
PBV Multiple	16.78	20%	3.36
PE Multiple	14.86	5%	0.74
Target Price			**19.9**
Current Price			**14.7**
Upside/(Downside)			35.6%
Dividend Yield			5.4%
Total Return			**41.0%**

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

Cytonn INVESTMENTS

IV. Standard Chartered Bank

Financial Statements Extracts

Standard Chartered's PAT is expected to grow at a 5-year CAGR of 5.5%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	19.4	18.6	18.7	20.5	21.5
Non Funded Income	8.6	8.8	8.7	8.4	8.9
Loan Loss Provision	2.2	4.2	2.9	2.7	2.9
Other Operating Expenses	12.5	13.1	13.5	14.3	15.2
Total Operating Expenses	**14.7**	**17.3**	**16.4**	**17.1**	**18.1**
Profit Before Tax	13.3	10.1	11.0	11.8	12.3
Profit After tax	9.1	6.9	7.7	8.2	8.6
% PAT Change YoY	**42.7%**	**(23.6%)**	**11.3%**	**7.1%**	**4.1%**
EPS	26.3	20.1	22.4	24.0	25.0
DPS	20.0	17.0	17.0	15.6	16.2
Cost to Income	52.5%	63.2%	59.9%	59.2%	59.6%
NIM	9.6%	7.9%	7.6%	8.5%	8.5%
ROaE	21.3%	15.4%	16.5%	16.8%	16.5%
ROaA	3.7%	2.6%	2.6%	2.7%	2.7%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Net Loans and Advances	122.7	126.3	106.0	112.4	118.6
Government Securities	86.9	110.5	119.6	127.0	134.0
Other assets	40.7	48.9	72.8	75.8	79.2
Total Assets	**250.3**	**285.7**	**298.4**	**315.2**	**331.8**
Customer Deposits	186.6	213.3	230.5	244.3	257.7
Other Liabilities	19.8	26.7	20.3	20.4	20.5
Total Liabilities	**206.4**	**240.1**	**250.8**	**264.7**	**278.3**
Shareholders Equity	43.9	45.7	47.6	50.5	53.5
Total Liabilities and Shareholders Equity	**250.3**	**285.7**	**298.4**	**315.2**	**331.8**

Cytonn INVESTMENTS

Valuation Summary

Standard Chartered Bank is under-valued with a total potential return of 7.7%

Cost of Equity Assumptions:	20/09/2018
Default spread adjusted Risk free rate*	13.20%
Beta	0.69
Country Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	16.8%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.4%
Return on Average Equity	17.3%
Terminal Price to Book value per share	1.5x
Shareholder Equity - FY22e	55.4
Terminal Value-(Year 2022)	82.2

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	210.56	40%	84.22
Residual Income	195.59	35%	68.46
PBV Multiple	178.30	20%	35.66
PE Multiple	166.24	5%	8.31
Target Price			**196.3**
Current Price			**198.0**
Upside/(Downside)			(0.8%)
Dividend Yield			8.6%
Total Return			**7.7%**

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

V. Barclays Bank Kenya

Financial Statements Extracts

Barclays Bank Kenya's PAT is expected to grow at a 5-year CAGR of 5.8%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	22.3	21.8	22.4	24.1	25.7
Non Funded Income	9.3	8.5	8.2	9.5	10.1
Total Operating Income	**31.7**	**30.3**	**30.7**	**33.6**	**35.9**
Loan Loss Provision	(3.9)	(3.1)	(3.0)	(3.6)	(3.9)
Other Operating Expenses	(16.9)	(16.8)	(17.2)	(18.7)	(20.0)
Total Operating Expenses	**(20.8)**	**(19.9)**	**(20.2)**	**(22.3)**	**(23.9)**
Profit Before Tax	10.9	10.4	10.4	11.3	11.9
Profit After tax	**7.4**	**6.9**	**7.3**	**7.9**	**8.3**
% PAT Change YoY	**-11.9%**	**-6.4%**	**5.6%**	**8.4%**	**5.2%**
EPS	1.4	1.3	1.3	1.5	1.5
DPS	1.0	1.0	1.0	1.0	1.0
Cost to Income	65.7%	65.8%	65.9%	66.3%	66.8%
NIM	10.5%	9.7%	9.1%	9.1%	9.2%
ROaE	18.0%	16.0%	17.6%	19.7%	19.5%
ROaA	3.0%	2.7%	2.7%	2.7%	2.8%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Net Loans and Advances	168.5	168.4	177.8	188.5	197.3
Government Securities	48.7	58.5	72.0	74.0	78.4
Other Assets	42.5	44.3	73.9	78.0	82.9
Total Assets	**259.7**	**271.2**	**323.7**	**340.5**	**358.7**
Customer Deposits	178.2	186.0	225.1	238.6	253.0
Other Liabilities	39.1	41.1	59.7	60.5	61.4
Total Liabilities	**217.3**	**227.1**	**284.8**	**299.1**	**314.3**
Shareholders Equity	42.4	44.1	38.9	41.4	44.3
Total Liabilities and Shareholders Equity	**259.7**	**271.2**	**323.7**	**340.5**	**358.7**

Valuation Summary

Barclays Bank Kenya is undervalued with a total potential return of 34.7%

Cost of Equity Assumptions:	18-Sep-18
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.90
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	19.0%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	18.4%
Return on Average Equity 2022	19.3%
Terminal Price to Book value per share	1.5x
Shareholder Equity - FY22e	51.05
Terminal Value-(Year 2021)	80.41

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	10.6	40%	4.2
Residual Income	16.1	35%	5.6
PBV Multiple	10.6	20%	2.1
PE Multiple	9.5	5%	0.5
Target Price			**12.5**
Current Price			**10.0**
Upside/(Downside)			25.0%
Dividend Yield			9.7%
Total Return			***34.7%***

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

Cytonn INVESTMENTS

VI. Diamond Trust Bank

Financial Statement Extracts

DTB has an estimated 5-year PAT CAGR of 6.7%

Income Statement	2016	2017	2018e	2019e	2020e
Net Interest Income	19.4	19.7	18.7	23.4	25.4
Non Funded Income	5.1	5.3	5.1	5.8	6.5
Loan Loss Provision	(4.3)	(4.3)	(2.0)	(4.5)	(5.1)
Other Operating Expenses	(9.2)	(10.6)	(10.7)	(12.6)	(13.8)
Total Operating Expenses	**(13.5)**	**(14.9)**	**(12.7)**	**(17.1)**	**(18.9)**
Profit Before Tax	11.0	10.1	11.1	12.1	13.0
Profit After tax	7.7	6.9	7.8	8.5	9.1
% PAT Change YoY	**17.0%**	**(10.3%)**	**12.0%**	**9.5%**	**7.5%**
EPS	27.6	24.8	27.7	30.4	32.6
DPS	2.6	2.6	2.8	3.1	3.3
Cost to Income	(37.6%)	(42.3%)	(45.0%)	(43.1%)	(43.2%)
NIM	7.4%	6.5%	5.7%	6.4%	6.2%
ROaE	20.5%	13.9%	14.8%	14.5%	13.7%
ROaA	2.6%	2.0%	2.0%	2.0%	1.9%
Balance Sheet	**2016**	**2017**	**2018**	**2019e**	**2020e**
Net Loans and Advances	186.3	196.0	211.6	242.4	270.1
Government Securities	92.8	114.4	116.4	132.7	147.6
Other Assets	49.0	52.9	62.3	60.9	62.7
Total Assets	**328.0**	**363.3**	**390.3**	**436.0**	**480.3**
Customer Deposits	238.1	266.2	293.1	328.3	367.7
Other Liabilities	44.1	43.4	38.9	42.1	39.1
Total Liabilities	**282.2**	**309.7**	**332.1**	**370.4**	**406.8**
Shareholders Equity	41.0	48.4	53.2	60.6	68.5
Total Liabilities and Shareholders Equity	**328.0**	**363.3**	**390.3**	**436.0**	**480.3**

Source – Company Financials

Valuation Summary

DTB's stock is undervalued with a total potential return of 63.6%

Cost of Equity Assumptions:	18/09/2018
Default Spread Adjusted Risk free rate*	13.20%
Beta	0.8
Mature Market Risk Premium	5.2%
Extra Risk Premium	1.5%
Cost of Equity	18.6%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	19.90%
Return on Average Equity 2022	13.2%
Terminal P/B	1.5x
Shareholder Equity - FY22e	87.06
Terminal Value-(Year 2022)	137.12

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	300.4	40.0%	120.2
Residual Income	284.2	35.0%	99.5
PBV Multiple	269.5	20.0%	53.9
PE Multiple	187.6	5.0%	9.4
Target Price			**283.7**
Current Price			**175.0**
Upside/(Downside)			62.1%
Dividend yield			1.5%
Total return			**63.6%**

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

Cytonn INVESTMENTS

VII. Stanbic Holdings

Financial Statements Extracts

Stanbic Holdings PAT is expected to grow at a 5-year CAGR of 5.9%

Income Statement	2016	2017	2018e	2019e	2020e	2021e
Net Interest Income	10.9	10.6	9.8	10.6	11.7	12.5
Non Funded Income	7.7	8.4	10.4	11.0	12.5	13.6
Loan Loss Provision	(1.8)	(2.8)	(2.6)	(3.4)	(4.2)	(5.0)
Total Operating Expenses	**(12.5)**	**(13.7)**	**(13.5)**	**(14.9)**	**(16.7)**	**(18.3)**
Profit Before Tax	6.0	5.4	6.7	6.8	7.5	7.8
Profit After tax	4.4	4.3	4.7	4.8	5.3	5.5
% PAT Change YoY	**-9.9%**	**-2.5%**	**8.7%**	**1.5%**	**11.0%**	**3.5%**
EPS	11.2	10.9	11.8	12.0	13.3	13.8
DPS	5.3	5.3	5.3	5.3	5.3	5.3
Cost to Income	57.9%	57.2%	54.0%	53.0%	51.5%	51.0%
NIM	**5.9%**	**5.2%**	**4.1%**	**4.0%**	**4.1%**	**4.1%**
ROaE	11.3%	10.4%	11.1%	11.2%	11.6%	11.2%
ROaA	2.1%	1.9%	1.8%	1.6%	1.7%	1.6%

Balance Sheet	2016	2017	2018e	2019e	2020e	2021e
Net Loans and Advances	132.6	143.3	163.1	175.4	192.4	207.4
Other Assets	82.1	105.5	121.7	123.8	129.4	133.4
Total Assets	**214.7**	**248.7**	**284.8**	**299.1**	**321.8**	**340.8**
Customer Deposits	155.8	193.4	217.9	233.2	249.5	269.5
Borrowings	4.0	4.0	7.0	7.0	7.0	7.0
Other Liabilities	14.7	8.4	18.6	15.0	18.1	13.8
Total Liabilities	**174.5**	**205.8**	**243.6**	**255.2**	**274.6**	**290.3**
Shareholders Equity	40.1	43.0	41.3	43.9	47.1	50.5
Total Liabilities and Shareholders Equity	**214.7**	**248.7**	**284.8**	**299.1**	**321.8**	**340.8**

Cytonn INVESTMENTS

Valuation Summary

Stanbic Holdings is slightly undervalued with a total potential upside of 2.5%

Cost of Equity Assumptions:	20-Sep-18
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.7
Mature Market Risk Premium	5.2%
Extra Risk Premium	1.0%
Cost of Equity	17.8%
Adjusted Beta	**0.9**

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.00
Terminal Cost of Equity	19.40%
Return on Average Equity	11.0%
Persistency Factor	0.50
Terminal Price to Book value per share	1.0x

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	94.2	40%	37.7
Residual Income	104.1	35%	36.4
PBV Multiple	72.8	20%	14.6
PE Multiple	81.2	5%	4.1
Target Price			**92.6**
Current Price			**95.5**
Dividend Yield			**5.5%**
Upside/(Downside)			**2.5%**

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

C. Tier II Banks

Tier 2 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
National Bank	• Introduction of Islamic Banking and the SME banking units. The SME products inlude Jenga Chama, Jenga Kilimo and Jenga Biashara • The introduction of bancassurance and custodial services has seen the bank diversify its revenue	• Capital ratios are below the regulatory requirement. However, their major shareholders have firm commitments to inject additional capital in order to meet the statutory capital requirements
NIC Bank	• Increased investment in digital platforms, NIC Now and Internet banking • NIC bank has maintained its pole positioning in asset financing and curved a niche in the market	• Traditional SME market now being targeted by Tier 1 banks, hence it’s market share is under threat • Exposure to different political, economic and regulatory environments, with their regional business i.e. Tanzania in a loss making position
HF Group	• Vibrant real estate market in Kenya with an annual housing supply which does not satisfy demand • The bank recently launched its online banking app HF whizz, which may likely boost its NFI	• Lack of a vibrant mortgage market in Kenya • Competition from larger banks such as KCB with Mortgage facilities poses a risk for growth • Asset liability mismatch which forces the bank to resort to expensive financing, unable to raise deposits
I&M Holdings	• They have consistently been among the most efficient banks in Kenya from a survey released by Think Business Banking Awards • They have also fully embraced internet bank in Kenya to further help drive their efficiency • Acquisitions are contributing positively to their NFI growth	• They have not been able to aggressively market themselves as a local household bank as Equity, Co-op and KCB • They face stiff competition for clients from larger existing tier 1 bank in the SME and Retail sectors • The bank had a deterioration in asset quality, unmatched by the provisioning level, with the bank having the third worst coverage

I. National Bank of Kenya

Financial Statements Extracts

National Bank's PAT is expected to grow at a 5-year CAGR of 5.1%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	7.8	6.7	5.6	6.9	7.5
Non Funded Income	2.9	2.4	2.4	2.4	2.5
Loan Loss Provision	2.4	0.8	0.7	0.7	0.8
Other Expenses	8.2	7.6	7.5	8.1	8.6
Total Operating Expenses	**10.6**	**8.4**	**8.2**	**8.8**	**9.4**
Profit Before Tax	0.1	0.8	(0.8)	0.4	0.6
Profit After tax	**0.1**	**0.4**	**(0.6)**	**0.3**	**0.4**
% PAT Change YoY	**-106.2%**	**479.0%**	**(236.6%)**	**(155.6)%**	**34.0%**
EPS	0.2	1.2	(1.7)	0.9	1.2
DPS	-	-	-	-	-
Cost to Income	76.6%	83.2%	93.9%	87.5%	86.1%
NIM	8.2%	7.4%	6.1%	7.2%	7.5%
ROaE	0.8%	5.8%	-8.8%	5.4%	6.9%
ROaA	0.1%	0.4%	-0.5%	0.3%	0.4%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	55.0	52.4	47.6	48.1	49.8
Government Securities	34.5	35.7	42.8	47.1	47.8
Other Assets	22.5	21.8	25.0	22.7	19.9
Total Assets	**112.1**	**109.9**	**115.5**	**117.9**	**117.5**
Customer Deposits	93.9	94.3	95.2	96.2	97.6
Other Liabilities	11.3	8.4	14.7	15.9	13.6
Total Liabilities	**105.2**	**102.6**	**109.9**	**112.0**	**111.2**
Shareholders Equity	6.9	7.2	5.6	5.9	6.3
Total Liabilities and Shareholders Equity	**112.1**	**109.9**	**115.5**	**117.9**	**117.5**

Valuation Summary

National Bank is overvalued with a total potential downside of 5.8%

Cost of Equity Assumptions:	20-Sep-18
Default Spread Adjusted Risk free rate*	13.2%
Beta	1.34
Mature Market Risk Premium	5.2%
Extra Risk Premium	2.5%
Cost of Equity	23.5%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	21%
Return on Average Equity	7.5%
Terminal Price to Book value per share	0.50x
Preference Shares	5.68

Valuation Summary:	Implied Price	Weighting	Weighted Value
Integrated DDM	4.04	40%	1.6
Residual Income	11.10	35%	3.9
PBV Multiple	4.23	20%	0.8
PE Multiple	4.14	5%	0.2
Target Price			**4.9**
Current Price			**5.3**
Upside/(Downside)			-5.8%

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

Cytonn INVESTMENTS

II. NIC Group

Financial Statements Extracts

NIC Group's PAT is expected to grow at a CAGR of 6.7%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	12.2	10.8	11.6	13.3	14.7
Non Funded Income	4.0	4.2	4.4	4.7	5.1
Loan Loss Provision	3.7	3.0	2.9	3.6	4.1
Total Operating Expenses	10.0	9.3	9.9	11.1	12.1
Profit Before Tax	6.2	5.6	6.1	6.9	7.7
Profit After tax	4.3	4.1	4.3	4.9	5.4
% PAT Change YoY	**-3.3%**	**-4.3%**	**3.7%**	**12.9%**	**10.8%**
EPS	6.8	6.5	6.7	7.6	8.4
DPS	1.3	1.0	1.1	1.1	1.1
Cost to Income	61.9%	62.5%	61.6%	61.5%	61.2%
NIM	8.0%	6.3%	5.9%	6.1%	6.2%
ROE	15.5%	12.9%	11.8%	11.9%	11.9%
ROA	2.6%	2.2%	2.0%	2.1%	2.1%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Net Loans and Advances	114.5	119.8	135.9	149.5	164.5
Government Securities	30.5	54.2	59.1	65.0	71.5
Other Assets	24.5	32.2	32.1	31.4	36.4
Total Assets	**169.5**	**206.2**	**227.1**	**245.9**	**272.3**
Customer Deposits	111.8	138.9	161.8	178.0	195.8
Other Liabilities	27.3	32.5	26.2	24.7	28.7
Total Liabilities	**139.1**	**171.5**	**188.0**	**202.7**	**224.4**
Shareholders Equity	29.8	34.2	38.6	42.7	47.4
Total Liabilities and Shareholders Equity	**169.5**	**206.2**	**227.1**	**245.9**	**272.3**

Valuation Summary

NIC Group is undervalued with a total potential return of 77.9%

Cost of Equity Assumptions:	18/09/2018
Default Spread Adjusted Risk free rate*	13.20%
Beta	0.90
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	17.9%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	18.40%
Return on Average Equity 2022	10.5%
Terminal Price to Book	1.2x
Shareholder Equity - FY22e	47.15
Terminal Value-(Year 2022)	59.41

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	54.3	40%	21.7
Residual Valuation	45.6	35%	16.0
PBV Multiple	46.2	20%	9.2
PE Multiple	33.4	5%	1.7
Target Price			**48.8**
Current Price			**28.0**
Upside/(Downside)			74.3%
Dividend Yield			3.6%
Total Potential Return			**77.9%**

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

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III. I&M Holdings

Financial Statements Extracts

I&M Holdings PAT is expected to grow at a 5-year CAGR of 3.6%

Income Statement	2016	2017f	2018f	2019f	2020f
Net Interest Income	15.5	15.6	16.3	19.4	20.9
Non Funded Income	5.2	5.8	6.4	5.4	5.8
Total Operating Income	**20.8**	**21.3**	**22.7**	**24.7**	**26.7**
Loan Loss Provision	3.0	4.1	3.7	4.1	4.6
Other Operating Expenses	7.2	7.8	8.6	9.2	10.2
Total Operating Expenses	**10.2**	**12.0**	**12.3**	**13.4**	**14.8**
Profit Before Tax	10.6	9.9	10.9	11.9	12.4
Profit After tax	7.8	7.3	7.6	8.3	8.7
EPS	**19.8**	**18.5**	**19.5**	**21.2**	**22.2**
% PAT Change YoY	**8.6%**	**(6.4%)**	**5.1%**	**9.1%**	**4.5%**
EPS	19.8	18.5	19.5	21.2	22.2
DPS	3.5	3.5	3.5	3.5	3.5
CIR	34.7%	36.8%	37.7%	37.4%	38.2%
NIM	8.6%	7.8%	7.1%	7.5%	7.6%
ROaE	21.3%	17.9%	16.6%	17.6%	18.7%
ROaA	3.6%	3.2%	2.9%	2.8%	2.7%
Balance Sheet	**2016e**	**2017f**	**2018f**	**2019f**	**2020f**
Investment Securities	45.8	50.8	67.0	72.2	78.0
Net Loans and Advances	134.7	153.0	173.0	184.0	196.2
Other Assets	30.1	36.2	51.0	51.9	51.8
Total Assets	**210.5**	**240.1**	**291.0**	**308.0**	**325.9**
Customer Deposits	146.5	169.3	216.2	232.8	251.5
Other Liabilities	24.5	23.8	24.4	25.4	25.6
Total Liabilities	**171.0**	**193.1**	**240.6**	**258.2**	**277.1**
Shareholders Equity	37.0	44.3	47.7	47.0	46.0
Total Liabilities and Shareholders Equity	**210.5**	**240.1**	**291.0**	**308.0**	**325.9**

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Valuation Summary

I&M Holdings is undervalued with a total potential return of 49.6%

Cost of Equity Assumptions:	18/09/2018
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.9
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.5%
Cost of Equity	18.3%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	18.90%
Return on Average Equity 2022	22.5%
Terminal Price to Book value per share	1.3x
Shareholder Equity - FY22e	44,706.23
Terminal Value-(Year 2022)	58,676.93

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	153.90	40%	61.56
Residual income	149.44	35%	52.31
PBV Multiple	99.18	20%	19.84
PE Multiple	97.78	5%	4.89
Target Price			**138.6**
Current Price			**95.0**
Upside/(Downside)			45.9%
Dividend yield			3.7%
Total return			**49.6%**

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

IV. HF Group

Financial Statements Extracts

HF Group's PAT is expected to grow at a 5-year CAGR of 5.0%

Income Statement	2016	2017	2018e	2019e	2020e
Net Interest Income	3.9	3.0	2.5	2.5	2.6
Non Funded Income	0.8	1.3	1.4	1.5	1.6
Loan Loss Provision	(0.7)	(0.6)	(0.7)	(0.6)	(0.7)
Other Operating Expenses	(2.6)	(3.4)	(3.2)	(3.1)	(3.3)
Total Operating Expenses	-3.3	-4.0	-3.9	-3.8	-4.0
Profit Before Tax	1.4	0.3	0.1	0.2	0.1
Profit After tax	0.9	0.1	0.0	0.1	0.1
% PAT Change YoY	**-24.3%**	**-86.1%**	**-63.6%**	**177.6%**	**-19.3%**
EPS	2.3	0.3	0.1	0.3	0.3
DPS	0.0	0.0	0.1	0.1	0.1
Cost to Income	56.3%	78.9%	80.8%	79.1%	79.1%
NIM	6.5%	5.2%	4.4%	4.6%	4.6%
ROaE	8.3%	1.1%	0.4%	1.1%	0.9%
ROaA	1.3%	0.2%	0.1%	0.2%	0.1%

Balance Sheet	2016	2017	2018e	2019e	2020e
Net Loans and Advances	54.5	49.6	48.7	50.4	52.6
Government Securities	4.1	2.3	2.8	2.9	3.3
Other Assets	13.4	15.6	14.9	15.2	15.5
Total Assets	71.9	67.5	66.5	68.4	71.4
Customer Deposits	38.1	36.7	36.9	39.0	41.1
Other Liabilities	22.6	19.4	18.3	18.2	18.9
Total Liabilities	**60.6**	**56.1**	**55.3**	**57.2**	**60.0**
Shareholders Equity	11.3	11.4	11.2	11.3	11.4
Total Liabilities to Shareholders Equity	71.9	67.5	66.5	68.4	71.4

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Valuation Summary

HF Group is undervalued with a total potential return of 2.3%

Cost of Equity Assumptions:	20/09/201818
Default Spread Adjusted Risk free rate	13.2%*
Beta	1.10
Country Risk Premium	5.2%
Extra Risk Premium	1.5%
Cost of Equity	20.6%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	20%
Return on Average Equity	1.4%
Terminal Price to Book	0.5x
Shareholder Equity - FY22e	10.4
Terminal Value-(Year 2022)	5.22

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	9.1	40%	3.7
Residual Income	2.4	35%	0.8
PTBV Multiple	8.2	20%	1.6
PE Multiple	7.7	5%	0.4
Fair Value			**6.6**
Current Price			**6.8**
Upside/(Downside)			(2.9%)
Dividend Yield			5.2%
Total return			***2.3%***

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

Feedback Summary

During the preparation of this H1’2018 Banking Sector Report, we shared with the subject companies the operating metrics that were used in the rankings 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
Diamond Trust Bank	Yes	Yes
NIC Group	Yes	Yes
National Bank of Kenya	Yes	Yes
Equity Group Holdings	Yes	Yes
Cooperative Bank Kenya	Yes	Unresponsive
Standard Chartered Bank Kenya	Yes	Unresponsive
Housing Finance Group	Yes	Unresponsive
Stanbic Holdings	Yes	Unresponsive
I&M Holdings	Yes	Unresponsive
Barclays Bank of Kenya	Yes	Unresponsive
KCB Group	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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