Kenya Listed Commercial Banks Analysis
Cytonn Q3'2018 Banking Sector Report

"Deteriorating Asset Quality Dampens Growth"

Cytonn

Sunday, 16 December 2018

The Alma
SIMPLY EXCEPTIONAL

Cytonn
Delivering to promise

I. Introduction to Cytonn

About Us

Cytonn Investments is an alternative investment manager with a primary focus on real estate investments in the high growth East African Region. In addition to real estate, Cytonn invests in educational facilities and hospitality, which are complimentary to its real estate developments. We have a unique strategy of coupling two compelling demand areas - the lack of high yielding investment products due to the large banking spread, and the lack of institutional grade real estate; by manufacturing high yielding instruments to attract funding from investors, and we deploy that funding to investment grade, well planned and comprehensive real estate developments that are largely pre-sold.

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

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

Our Business Structure

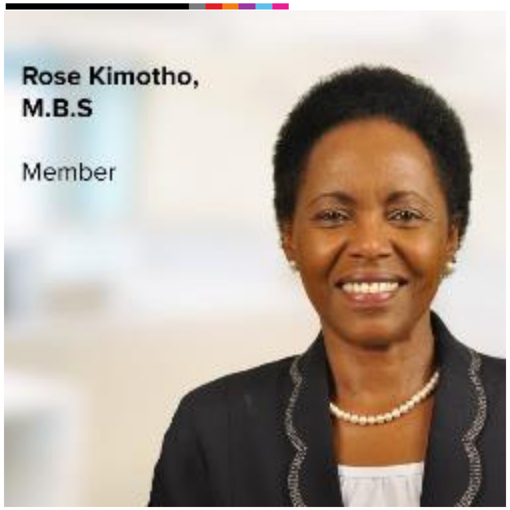
Cytonn Investments Management Plc

- **Cytonn Capital Partners** (Private Markets)
  - Private Offers and Real Estate Investments
  - Cytonn Hospitality
  - Cytonn Education Services
  - Superior Homes Kenya
  - Serviced Offices
- **Cytonn Asset Managers** (Regulated by Capital Markets Authority)
  - 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

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 12 members from diverse backgrounds, each bringing in unique skill-sets to the firm.

Board of Directors



Governance: Board Committees

Investments and Strategy Committee

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

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

Audit, Risk and Compliance Committee

The committee establishes and oversees finance, audit, 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

Human Resources, Governance & Compensation Committee

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

- Rose Kimotho M.B.S (Chair)
- Antti-Jussi Ahveninen, MSc
- 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
- Rose Kimotho M.B.S
- Patricia N. Wanjama, CPS

Management Team

Edwin H. Dande, MBA
Managing Partner & CEO

Elizabeth N. Nkukuu, CFA
Chief Investments Officer

Patricia N. Wanjama, CPS
Partner, Head of Legal & Company Secretary

Shiv A. Arora, BSc.
Head - Private Equity Real Estate

Maurice Oduor, BBA
Investment Manager

Johnson Denge, MISK
Senior Manager, Regional Markets

Pankaj Tyagi
Senior Development Manager

Martin Gitonga, BA
Senior Project Manager

Management Team

Gitonga M. Muriithi, MBA, FCIM
Senior Marketing & Brand Manager

Benjamin N. Ikenye, MA, AMP
Business Manager, Education Services

Kimathi K. Muchiri, MSc, CPA (K)
Internal Audit Manager

Daniel N. Mainye, MBA
Business Manager, Technologies

Anne Joseph, BA, CHRM
Assistant HR Manager

Grace W. Weru, BA, CPA (K)
Finance & Administration Manager

Cytonn's Business Overview

Where we Raise Money

- **Local High-net-worth Investors via a captive distribution of 250 Financial Advisors and 300 Independent Financial Advisors**
- **Global & Local Institutions such as Taaleri of Finland**
- **Diaspora via our office in the Washington DC Metro Area**
- **Retail & Pension via Cytonn Asset Managers**

Where we Invest

- **Real Estate –** 84.8%
- **Financial Services** - 4.6%
- **Education** – 0.8%
- **Hospitality -** 9.8%
- **Procurement –** Just Started

How we Exit

- **Individuals i.e. Cytonn Distribution**
- **Institutions**
- **Investment Vehicles**

  Partnership Units (LLP)
  REIT's Fund
  Other Income Funds

Strategic Support Services	**1. Finance**	**2. ICT**	**3. Legal & Compliance**	**4. Brand (PR & Communication)**	**5. CS**
	6.HR	**7. Risk**	**8. Business Admin**	**9. Fund Operations**	**10. Internal Audit**

II Kenya Economic Review and Outlook

Cytonn

Kenya Economic Review

Of the 7 indicators we track, 4 are positive and 3 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 5.3% - 5.5% , from 4.9% recorded in 2017	Kenya's economy grew by 6.3% in Q2'2018, compared to 4.7% in Q2'2017. The consensus GDP growth projection for Kenya in 2018 is at 5.5% (an average taken from 15 research firms, global agencies and government organizations projections), which is an improvement from the GDP growth experienced in 2017	GDP growth is projected to come in between 5.3%-5.5%, 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) maintained the Central Bank Rate (CBR) at 9.0% on the meeting held on 27th November 2018, citing that inflation expectations were still well anchored within the target range and that the economy was operating close to its potential	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 4.6% in the first 11 months of 2018 compared to 8.3% in a similar period in 2017. The Y/Y inflation rate for the month of November increased to 5.6% from 5.5% recorded in October. The Y/Y rise was mainly due to the base effect as inflation was on a decline in the last quarter of 2017. M/M inflation however declined by 0.2%, attributed to a 0.2% decline in the food and non-alcoholic beverages index coupled with a 1.2% decline in the housing, water, electricity, gas and other fuels index.	Inflation in 2018 will be within the government's set target 0f 2.5%-7.5% , down from 8.0% in 2017 mainly driven by the decline in food prices attributed to improved weather conditions during the year. Going forward, we expect upward inflationary pressure as the effects of the rise in fuel and transport prices due to the introduction of 8.0% VAT on petroleum products as well as implementation of the various tax reforms in the government's fiscal consolidation plan targeting to increase revenue mobilization continue being felt	**Positive**	**Positive**

Source – CBK

Kenya Economic Review, continued…

Of the 7 indicators we track, 4 are positive and 3 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 0.6% against the USD YTD to 100.8 The current account deficit narrowed to 5.3% in the 12-months to September 2018, from 6.5% in September 2017. It is expected to narrow further to 5.2% of GDP in 2018, from 6.3% in 2017, largely due to 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. improving diaspora remittances which increased by 71.9% y/y, and by 4.9% m/m, from USD 253.7 mn in May 2018 , ii. the ample forex reserves currently at USD 8.6 bn (equivalent to 5.7 months of import cover), and iii. 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	**Neutral**	**Neutral**
Corporate Earnings	Corporate earnings growth of 8.0% in 2018 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 16.4% in Q3'2018	We expect corporate earnings in various sectors to improve in 2018 compared to 2017, driven by improved macro economic fundamental evidenced by the GDP in Q2'2018 having expanded by 6.3% as well as resilience in the private sector with Kenya's Stanbic PMI having averaged 54.4 in the 11 months to November, compared to 46.0 in a similar period in 2017, indicating an improvement in the business environment	**Positive**	**Positive**

Source – CBK

Kenya Economic Review, continued…

Of the 7 indicators we track, 4 are positive and 3 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 yields on Kenyan Eurobonds have been on the rise, reflecting higher risk perception by investors, partly been attributed to the increment in the Federal Rate twice this year, currently at 2.00% - 2.25% which has led to market correction in Eurobond yields in the emerging markets • Foreign investors have been net sellers in the NSE with the cumulative net outflows in the 11 months to November coming in at USD 272.3 mn, a 135% rise from USD 115.8 mn in a similar period in 2017	• We expect investor sentiment to improve in the long term with investors entering the market seeking to take advantage of the valuations which are still historically low • In the near-term however, we expect the market to remain subdued as international investors exit the broader emerging markets due to the expectation of rising US interest rates coupled with the strengthening of the US Dollar.	**Positive**	**Neutral**
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 promoting the economic transformation agenda	**Positive**	**Positive**

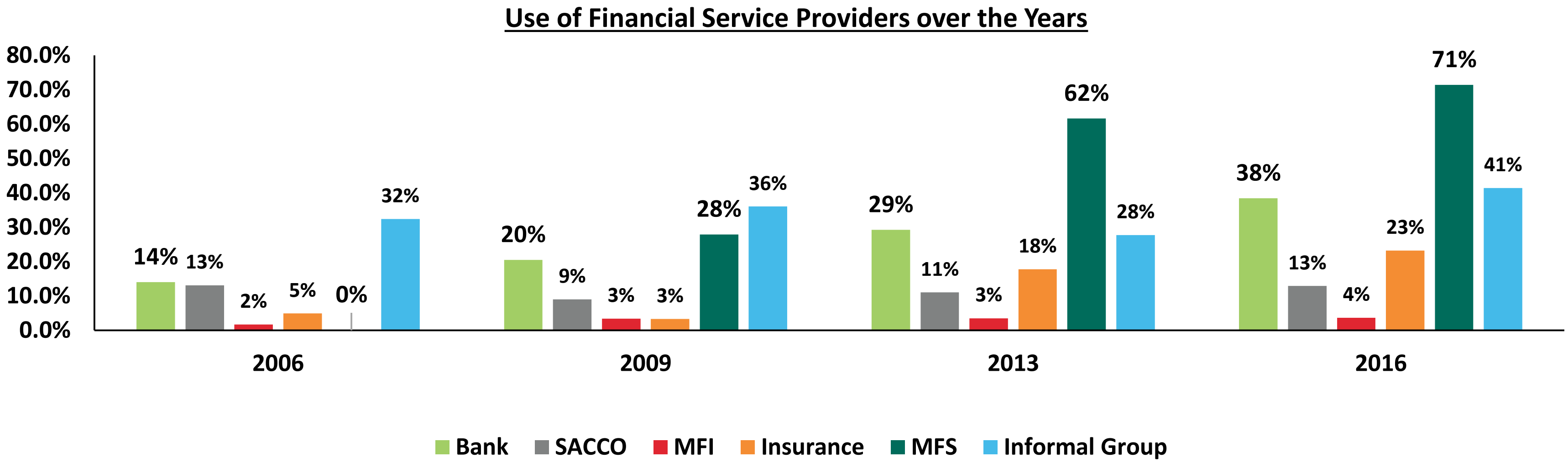
Source – CBK

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 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



Source: Central Bank of Kenya

Kenya Banking Sector Overview, continued…

Consolidation continues in the banking sector, with the latest being that of a possible merger between NIC Group and CBA Bank

- Kenya's banking environment has been going through consolidation as evidenced by heightened M&A activity over the last 4 years. In H1'2018, SBM Bank Kenya Ltd completed the acquisition of 75% of the value of all moratorium deposits at Chase Bank, with the remaining 25% to remain with Chase bank Limited. More recently, NIC Group and Commercial Bank of Africa (CBA) announced a potential merger subject to due diligence processes and approval from shareholders, the regulators such as the Capital Markets Authority (CMA) and Central Bank of Kenya (CBK), and other stakeholders. 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 banks' Q3'2018 EPS increased by 16.2% y/y from an average decline of 9.3% witnessed in Q3'2017

- Kenya's listed banks recorded a positive EPS growth of 16.2% in Q3'2018, compared to a 9.3% decline in Q3'2017, underlining the diversification strategies employed by banks in the wake of the interest-rate cap legislation, that was passed in September 2016, to navigate the relatively tougher operating environment
- The increase was on the back of a 3.8% increase in Net Interest Income (NII) coupled with a 5.9% growth in Non-Funded Income (NFI) as banks adapted to operating under the interest rate cap regime. The Net Interest Margin (NIM) decreased to 8.0% in Q3'2018 from 8.5% in Q3'2017
- The sector had an improvement in operating efficiency as the Cost to Income Ratio (CIR) declined to 56.3% in Q3'2018 from 59.8% in Q3'2017, amid cost rationalization measure such as branch closures, staff layoffs in voluntary retirement plans and digitization strategies aimed at reducing operational costs
- Listed banks recorded a slow net loans and advances growth of 4.2% y/y to Kshs 2.0 tn in Q3'2018 from Kshs 1.9 tn in Q3'2017. Deposits grew at a faster rate of 7.4% y/y to Kshs 2.6 tn in Q3'2018 from Kshs 2.4 tn in Q3'2017
- The sector had an improved profitability y/y, as shown by the rise in the Return on Average Equity (ROaE) to 18.8% in Q3'2018 from 17.5% in Q3'2017

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 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 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 bancassurance. 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 NFI to total revenue ratio standing at 34.5% from 33.3% in Q3'2017
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 National Assembly voted to retain the 4.0% cap on loans while removing the 70% floor on deposits

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:
    1. 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),
    2. 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 Cont….

Regulatory policies aimed at improving stability in the sector

3. The National Assembly Retains 4.0% Cap on loans while scrapping the 70% floor on deposit savings: 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 assented into law, in a move that is set to see banks reduce interest payable on deposits, thereby possibly alleviating the reduced Net Interest Margins (NIMs) that came with the law. In our view, the scrapping of the 70% base rate on deposits will serve to increase banks' net interest margins as banks will lower interest payable on deposits, hence bringing down the cost of funding for the banking sector

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 Cont….

Banks continue to seek alternative financing for onward lending to the private sector, in order to address asset-liability tenor mismatch

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 Period	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	10.0	2,3 years
5	Africa Development Bank	Diamond Trust bank	Mar-18	7.5	7-years
6	FMO	I&M Holdings	Oct-18	4.0	Not specified
7	IFC	I&M Holdings	Jan-18	1.0	Not specified
8	East African Development Bank	Sidian Bank	Nov-18	0.2	8-years
	Total			**48.9**	

Recent Developments in the Banking Sector Cont….

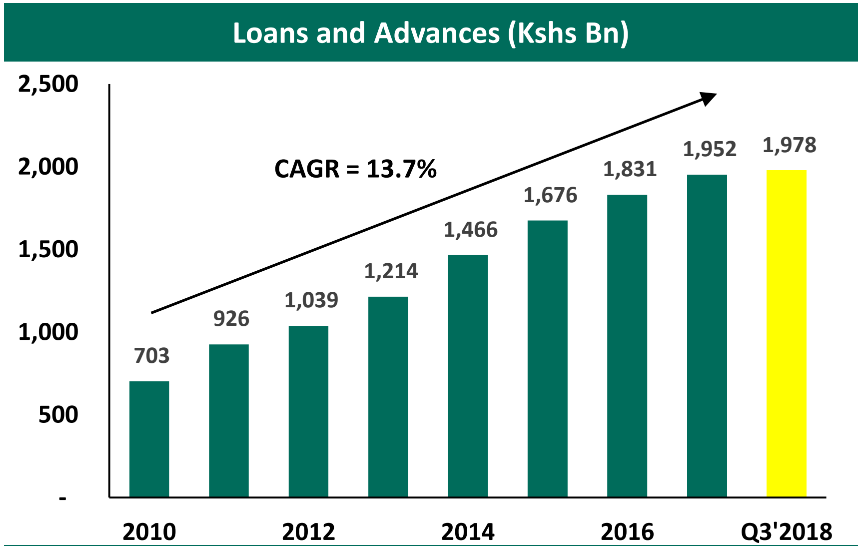
Barclays Kenya to rebrand to Absa by 2020, KCB advances on asset recovery efforts from troubled Imperial Bank

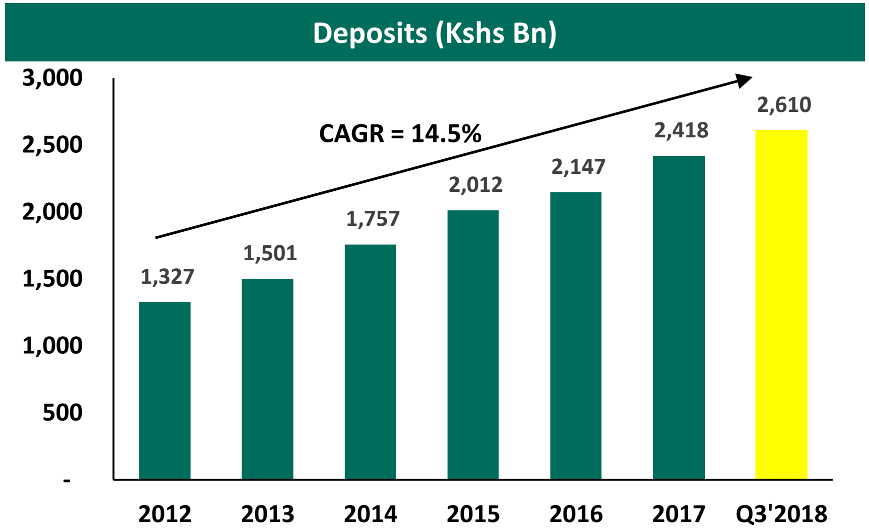
7. Barclays Kenya to Rebrand to Absa by 2020 – Following the London-based Barclays Plc's exit from the African market, Barclays Africa Group Limited changed its name to Absa Group, with the Kenyan subsidiary seeking to complete the rebranding process by 2020. Barclays Plc had acquired a majority stake of 56.4% in Absa Group in 2005, gradually increased its stake to 62.0% but reduced to 14.9% after selling to the large institutional investor Public Investment Corporation of South Africa (PIC). We are of the view that Barclays will be able to compete more favourably with its peers, as it plans to increase its market share in the region by 5 million customers during the rebranding process. With more localized decision-making, the lender is well positioned to quickly exploit any opportunities that arise as well as build on their innovative profile that has seen the bank offer efficient services to its customers.

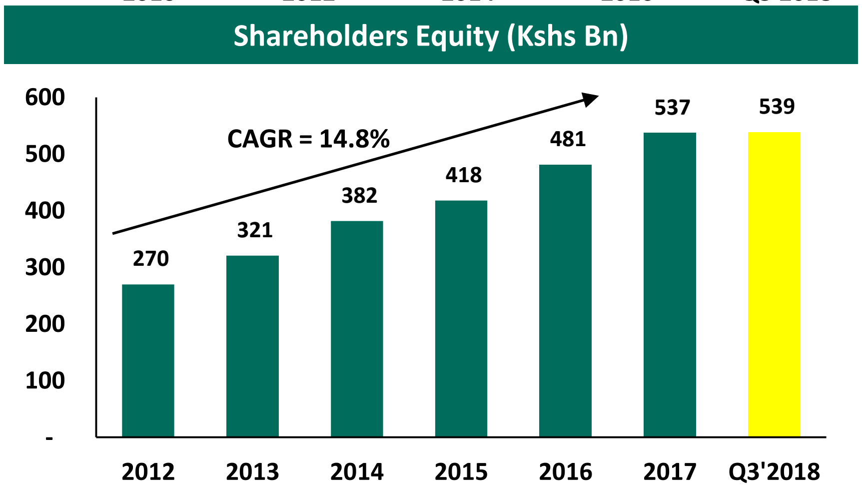
8. **KCB Group on track to acquire a stake in troubled Imperial Bank (under receivership) –** Kenya Deposit Insurance Corporation (KDIC) announced its acceptance of a binding offer on Imperial Bank by KCB Group. KCB had communicated to CBK and KDIC on the modification of the terms of the Binding Offer, which includes granting access to 12.7% of eligible depositor balances remaining at Imperial Bank within 14 days of the announcement, subject to account and identity verifications. The action will result in a total recovery of approximately 35.0% of original eligible deposits held at the date of receivership. In addition, the Binding Offer outlines that KCB will complete the loan verification process within Q1'2019, and is expected to result in further recoveries for eligible depositors of Imperial Bank. IBL was put under receivership in August 2015, with a loan book of Kshs 41.0 bn and deposits of Kshs 58.0 bn. We are of the view that KCB Group's Binding Offer represents a viable proposal for the resolution of IBL, for the benefit of depositors and the strengthening of the Kenyan financial sector.

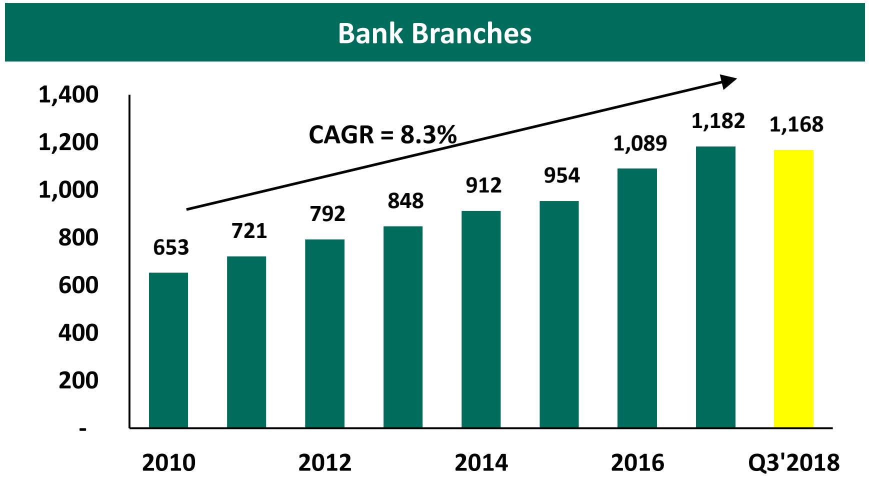
Listed Banking Sector Metrics

Deposit growth has remained strong, faster than the growth in loans and advances. The number of branches has grown slower by 8.3%, with a total of 14 branches closed YTD





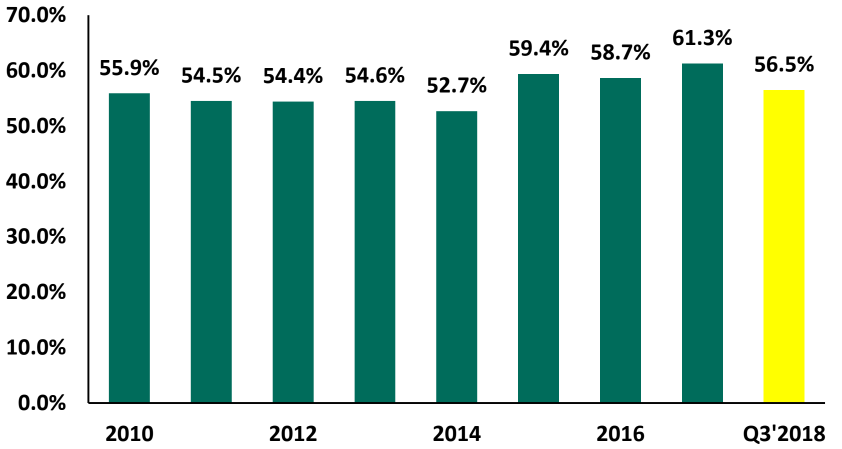




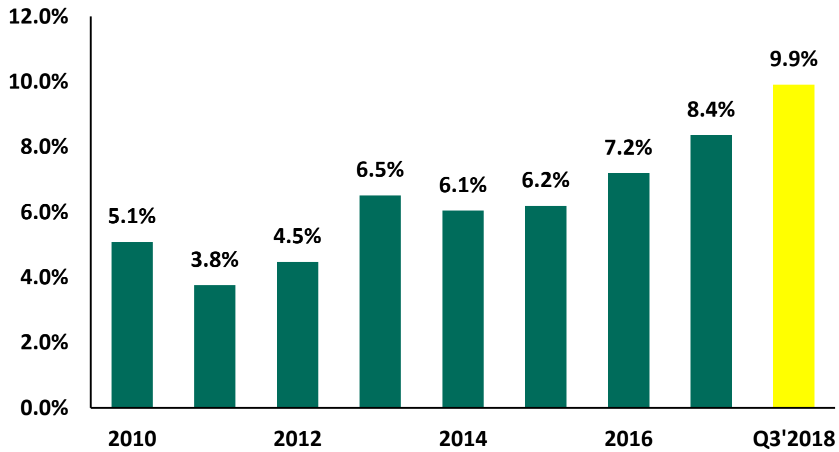
Listed Banking Sector Metrics

Under the current loan pricing framework, there has been reduced lending, leading to a lower NIM, with banks focusing on improving efficiency, amid a tough operating regime leading to asset quality deterioration

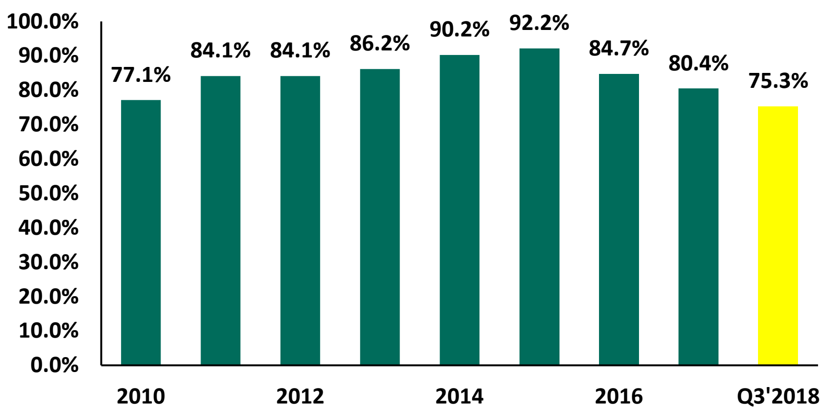
Cost to Income Ratio



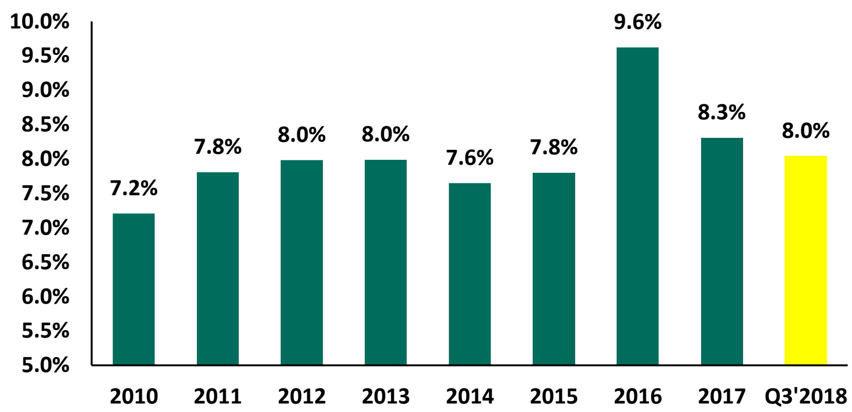
NPL Ratio



Loan to Deposit Ratio



Net Interest Margin



Listed Banking Earnings and Growth Metrics

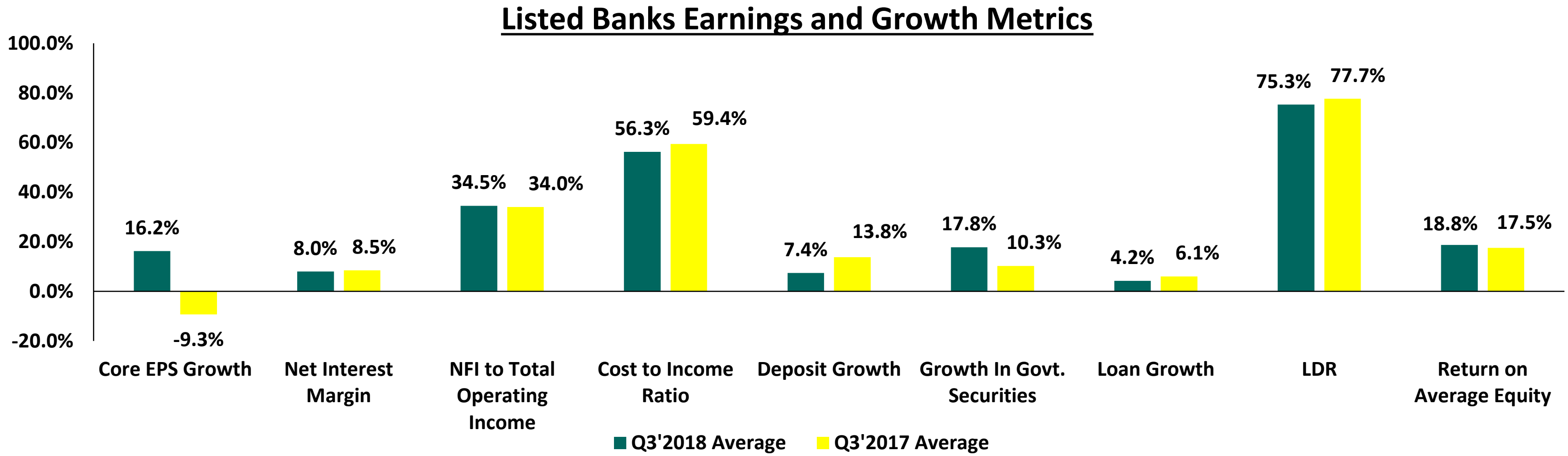
Kenya's listed banking sector Q3'2018 core EPS increased by 16.2% compared to a decline of 9.3% in Q3'2017, and consequently the ROaE improved to 18.8% from 17.5% in Q3'2017

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
NBK	303.2%	6.6%	26.8%	(4.7%)	3.2%	(17.1%)	51.7%	3.2%
Stanbic Bank	46.7%	4.9%	47.0%	20.3%	16.7%	16.3%	77.8%	14.3%
Standard Chartered	33.9%	8.5%	32.6%	(8.0%)	(6.1%)	(2.8%)	50.6%	18.6%
KCB Group	19.7%	8.5%	33.1%	6.2%	15.3%	3.8%	82.6%	21.7%
I&M Holdings	18.3%	6.7%	35.1%	27.6%	8.0%	8.6%	78.1%	17.2%
DTBK	10.0%	6.1%	21.7%	6.5%	17.7%	0.7%	70.0%	13.3%
Co-op Bank	8.2%	8.3%	32.7%	2.5%	16.9%	(2.0%)	85.9%	17.6%
Equity Group	8.1%	8.5%	40.0%	9.1%	24.1%	8.6%	71.7%	22.2%
Barclays Bank	2.0%	9.1%	30.8%	9.9%	29.5%	6.7%	81.0%	16.5%
NIC Group	(3.3%)	5.8%	30.9%	10.3%	16.2%	(3.1%)	79.3%	12.1%
HF Group	N/A	4.6%	25.0%	3.1%	429.5%	(11.3%)	90.7%	(3.3%)
Q3'2018 Average	**16.2%**	**8.0%**	**34.5%**	**7.4%**	**17.8%**	**4.2%**	**75.3%**	**18.8%**
Q3'2017 Average	**(9.3%)**	**8.5%**	**33.3%**	**13.8%**	**10.3%**	**6.1%**	**77.7%**	**17.5%**

** The weighted average is based on market capitalization as at 30th November 2018*

Listed Banks Earnings and Growth Metrics Cont…

Listed banks witnessed an improvement in operational efficiency, an improvement in total operating income, and consequently higher profitability in Q3'2018 compared to Q3'2017



- The listed banks recorded a 16.2% increase in core EPS, compared to a decline of 9.3% in Q3'2017, as a result of improved efficiency, with the Cost to Income Ratio improving to 56.3% from 59.4% in Q3'2017, as cost rationalization measures bear fruit, coupled with recovery in interest income as NII grew by 3.8% compared to a 7.3% decline in 2017
- The LDR has declined to 75.3% from 77.7% in Q3'2017, with banks now channeling funds more actively towards government securities which grew by 17.8% y/y, as loan growth came in at 4.2% a decline from a 6.1% increase in Q3'2017. Deposit growth remained strong at 7.4% y/y, albeit slower than the 13.8% growth in Q3'2017

Listed Banks Operating Metrics

Non-interest Income currently contributes to 34.5% of banks total operating income, from 34.0% in Q3'2017, with the industry's loan to deposit Ratio currently at 75.3%

Bank	LDR	CIR	ROACE	Deposit/Branch	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non Interest Income/Revenue
Equity Group	71.7%	54.6%	22.3%	1.4	8.9%	38.9%	15.0%	40.2%
KCB Group	82.6%	52.8%	21.7%	2.0	7.6%	60.4%	15.0%	33.1%
SCBK	50.6%	57.2%	18.6%	6.3	15.6%	74.2%	15.6%	32.6%
Stanbic Bank	77.8%	57.9%	18.0%	7.0	7.2%	60.6%	11.3%	46.5%
Coop Bank	85.9%	55.1%	17.6%	1.9	11.2%	36.8%	17.3%	32.7%
I&M Holdings	78.1%	51.7%	17.2%	5.1	12.7%	49.2%	14.9%	35.1%
Barclays Bank	81.0%	67.6%	16.5%	2.5	7.7%	70.5%	13.0%	30.8%
DTBK	70.0%	56.9%	13.3%	2.0	7.7%	72.5%	13.2%	21.7%
NIC Group	79.3%	60.6%	12.1%	3.0	13.0%	51.4%	15.9%	30.9%
HF Group	90.7%*	113.5%	10.2%	1.6	18.2%	42.4%	15.7%	25.0%
NBK	51.7%	87.5%	(3.3%)	1.3	47.1%	57.1%	5.1%	26.8%
Weighted Average Q3'2018**	**75.3%**	**56.5%**	**18.8%**	**2.9**	**9.9%**	**54.2%**	**14.8%**	**34.5%**

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

***Market cap weighted average as at 30th November 2018*

Listed Banks Operating Metrics

The listed banking sector is currently trading at an average P/TBv of 1.3x and average P/E of 6.6x

Bank	No. of shares (bn)	Market cap*	P/E	Price**	P/TBV	Dividend Yield
HF Group	0.4	2.1	**1.9x**	5.4	**0.2x**	1.9%
NBK	0.3	1.9	**6.7x**	5.7	**0.3x**	0.0%
NIC Group	0.7	18.8	**4.7x**	26.8	**0.6x**	3.7%
DTBK	0.3	41.4	**6.3x**	148	**0.8x**	1.8%
I&M Holdings	0.4	35.1	**4.5x**	85	**0.8x**	4.1%
Stanbic Holdings	0.4	36.4	**6.2x**	92	**1.1x**	5.7%
Coop Bank	5.9	84.8	**7.0x**	14.5	**1.2x**	5.5%
KCB Group	3.1	122	**5.4x**	39.8	**1.2x**	7.5%
Barclays Bank	5.4	58.4	**8.3x**	10.8	**1.4x**	9.0%
SCBK	0.3	66	**7.7x**	192	**1.5x**	8.9%
Equity Group	3.8	148.1	**7.4x**	39.3	**1.8x**	5.1%
Weighted Average Q3'2018* **			**6.6x**		**1.3x**	

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

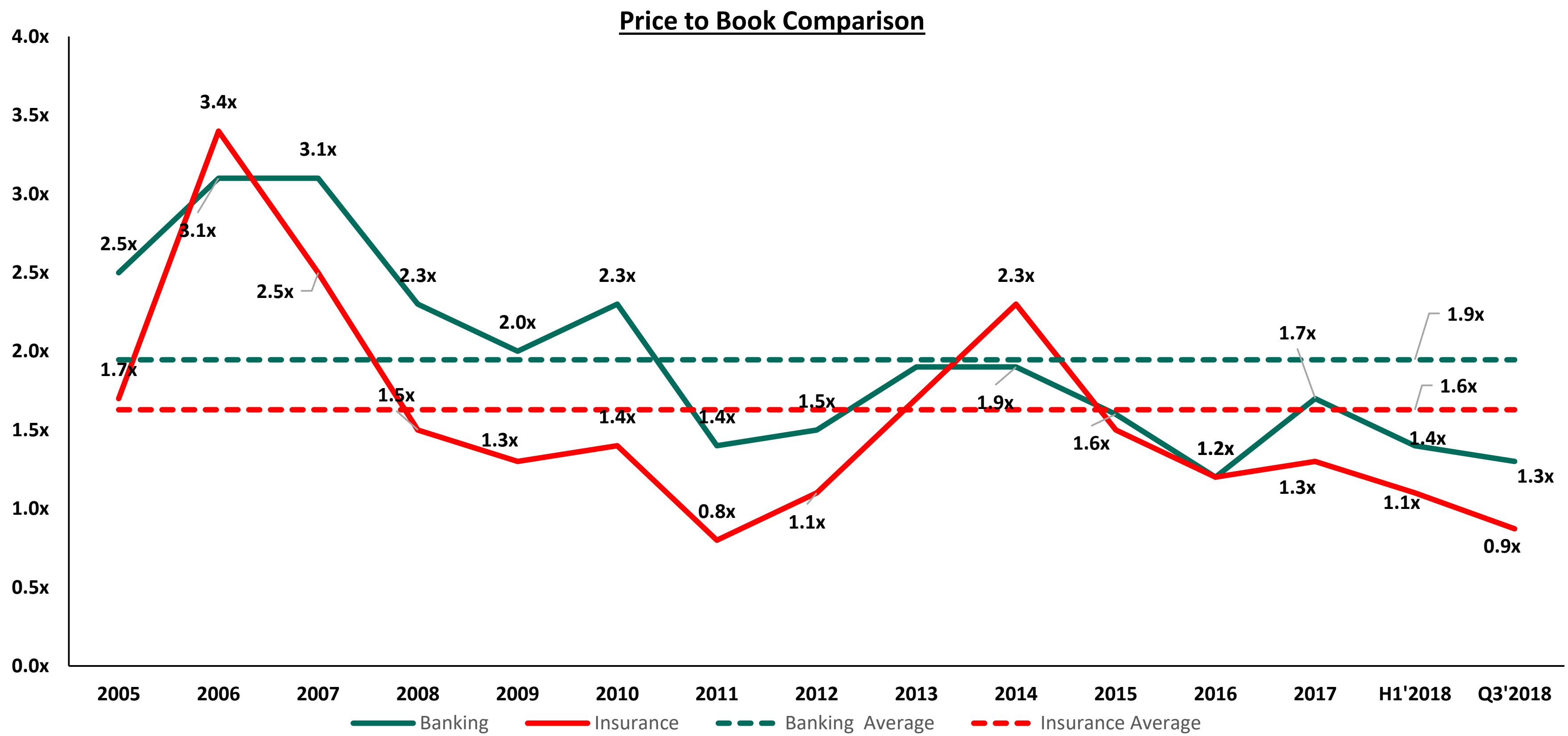
**Market cap as at 11/12/2018*

*** prices as at 11/12/2018* **** Market cap weighted average as at 30th November 2018*

Listed Banks Operating Metrics

Listed banks trade at an average P/B of 1.3x, higher than the insurance sector which has been priced at 0.9x. Both sectors are trading below their 13-year averages of 1.9x and 1.6x, respectively

13 year Price to Book Value: Banking and Insurance



On a price to book valuation, listed banks are currently priced at a PBV of 1.3x, higher than listed insurance companies at 0.9x, with both lower than their historical averages of 1.9x for the banking sector and 1.6x for the insurance sector

Summary of the Q3'2018 Earnings

The sector remains on course to achieve higher profitability in FY'2018, as core EPS has increased by 16.2% y/y in Q3'2018, compared to a 9.3% decline in a similar period in 2017

1. The sector continued to have an improved performance relative to a similar period in 2017, recording a market cap-weighted increase of 16.2% in core earnings per share in Q3'2018 compared to a market cap weighted decline of 9.3% in Q3'2017, showing that banks are adapting to the regulatory environment after the legislation capping interest rates was passed in August 2016, with the shift in business models bearing fruit, with non-funded revenue expansion and cost rationalization strategies taking effect. The performance was achieved despite the relatively tougher operating environment that has been witnessed in 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 9.9%, from 7.8% in Q3'2017. Banks cite delays in government payments and spilled over effects of 2017 as the major reasons for the rise in NPLs, in real estate, personal and household, and real estate segments. We expect the level of provisioning to increase going forward as banks continue to adopt IFRS 9 that requires a forward looking approach to estimate credit losses, coupled with increased provisioning for the deteriorating financial assets

3. Deposits grew at a faster pace than loans at 7.8% compared to loans at 4.2%, slower than 13.8% recorded in Q3'2017, indicating reduced intermediation between depositors and credit consumers, with the loan to deposit ratio declining to 75.3% from 77.7% in Q3'2017, as government securities investments rose by 17.8%, faster than the 10.3% recorded in Q3'2017

IV. Cytonn's Banking 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%)

A Deteriorating Asset Quality Dampens Growth

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, with deposit floor removed in Finance Act 2018 • **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 8.0% from 8.5% in Q3'2017, and should improve, • Banks total capital position relative to their risky assets declined by an average of 0.4% on IFRS 9 implementation. Lending policies are now 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, to counter the effect of compressed interest income	• Non-Funded Income growth has been emphasized in the new bank's business model, rising by 5.9% in Q3'2018, albeit slower than 10.9% recorded in Q3'2017. Revenue expansion by product diversification is one of the core opportunities for the banking sector to achieve sustainable growth
Consolidation	• **Various Acquisitions happening:** With increased competition amongst players in the banking sector, coupled with tough operating environment, several consolidations have happened.	• Consolidations in the sector have resulted in (i) aiding in successful removal of Chase Bank Ltd from receivership, and possibly Imperial Bank (ii) reduce the number of players in the sector, thereby leaving fewer but stronger players, thus creating a more stable banking sector
Asset Quality	• **Increase in non-performing loans:** With the Gross NPL ratio currently at 9.9%, up from 7.8% in Q3'2017, 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	Q3'2018 Rank	H1'2018 Rank
KCB Group	2	2	2	4	2	7	6	2	5	5	4	1	1	43	**1**	1
Coop Bank	1	4	5	5	5	8	8	6	11	1	5	5	5	69	**2**	3
Equity Group	8	3	1	2	3	11	10	5	10	6	2	3	5	69	**2**	2
I&M Holdings	5	1	6	6	4	5	3	7	8	7	3	6	9	70	**4**	4
Stanbic Holdings	6	7	4	10	8	6	1	1	4	10	1	2	11	71	**5**	6
SCBK	11	6	3	3	9	10	2	9	1	4	6	7	3	74	**6**	5
DTBK	9	5	8	8	6	4	7	3	2	8	11	7	1	79	**7**	8
NIC Group	4	8	9	9	7	3	4	8	7	2	7	9	3	80	**8**	9
Barclays Bank	3	9	7	1	11	9	5	4	3	9	8	4	8	81	**9**	6
HF Group	7	11	10	11	1	1	9	10	9	3	10	10	10	102	**10**	11
NBK	10	10	11	7	10	2	11	11	6	11	9	11	5	114	**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 52.8% compared to an industry average of 56.3%, an optimal LDR of 82.6%, an improved asset quality with an NPL ratio of 7.6%, a high ROACE of 21.7% compared to the industry average of 18.8%, as well as having the best CAMEL rating and Corporate Governance scores
- NBK ranked 11 owing to increased inefficiencies, with the Cost to Income Ratio at 99.3% as compared to an industry average of 56.3%, poor asset quality with NPL ratio at 47.1%, above the industry average of 9.9%, and a low capitalization and Camel rating score

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

Source: Cytonn Research

Rankings by Intrinsic Value

Equity Group has the highest upside with a total potential return of 72.8%

Bank	Current Price*	Target Price	Upside	Dividend Yield	Total Potential Return	Q3'2018 Ranking	H1'2018 Ranking
Equity Group	39.3	65.8	67.7%	5.1%	72.8%	**1**	5
KCB Group	39.8	64.0	60.7%	7.5%	68.3%	**2**	3
I&M Holdings	85.0	138.6	63.1%	4.3%	67.4%	**3**	4
DTBK	148.0	231.2	56.2%	1.8%	58.0%	**4**	2
NIC Group	26.8	40.7	52.1%	3.7%	55.8%	**5**	1
Coop Bank	14.5	19.4	34.0%	5.5%	39.5%	**6**	6
Barclays Bank	10.8	13.9	28.5%	9.3%	37.7%	**7**	7
HF Group	5.4	6.9	27.2%	1.9%	29.1%	**8**	10
SCBK	192.0	219.9	14.5%	8.9%	23.4%	**9**	8
Stanbic Holdings	92.0	102.7	11.6%	5.7%	17.3%	**10**	9
NBK	5.7	5.0	(12.1%)	0.0%	(12.1%)	**11**	11

***Prices as at 11th December 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
- Equity Group has the highest upside at 72.8%, followed by KCB Group and I&M Holdings at 68.3% and 67.2%, respectively
- Diamond Trust Bank dropped 2 positions to position 4 from 2 in H1’2018, with an expected return of 58.0%
- NIC Group dropped 4 positions to position 5 from 1st in H1’2018, with an expected upside of 55.8%

Composite Bank Ranking

Overall, KCB Group ranked highest, while 6 banks shifted positions from H1’2018

Bank	Franchise Value Total Score	Intrinsic Value Score	Weighted Score	Q3'2018 Rank	H1'2018 Rank
KCB Group	43	2	18.4	**1**	1
Equity Group	69	1	28.2	**2**	2
I&M Holdings	70	3	29.8	**3**	3
Coop Bank	69	6	31.2	**4**	4
DTBK	79	4	34.0	**5**	5
Stanbic Holdings	71	10	34.4	**6**	9
NIC Group	80	5	35.0	**7**	8
SCBK	74	9	35.0	**7**	7
Barclays Bank	81	7	36.6	**9**	6
HF Group	102	8	45.6	**10**	11
NBK	114	11	52.2	**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, Equity Group and I&M Holdings maintained the 1st, 2nd and 3rd positions, while Stanbic Holdings and NIC Group rose to 6th and 7th positions from 9th and 8th respectively, in H1’2018,
- Stanbic Holdings rose to position 6 from position 9 due to an improved franchise value score, with the bank having the lowest NPL ratio of 7.2%, lower than the industry average of 9.9%, the highest deposits per branch of Kshs 7.0 bn of above the industry average of Kshs 2.9 bn, and the highest NFI to total operating income ratio of 46.5%, above the 34.5% industry average, and,
- NIC Group rose 1 positions to position 7 from 8th in H1’2018, while Barclays dropped 3 spots to position 9 from 6th in H1’2018, with NIC’s rise attributed to an improved franchise value score, which improved to 80 from 87 in H1’2018,

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 9.1%, with the lowest HF Group at 4.6%

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 22.2%, while HF Group had the lowest at (3.3%)

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. KCB Group and Housing Finance had the lowest PEG ratio at 0.4x, while Barclays Bank was the most overvalued at 1.4x

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 Bank has the highest deposits per branch at Kshs 7.0 bn, while NBK had the lowest deposits per branch at Kshs 1.3 bn

Banking Sector Report – Metrics Used, Cont…

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 85.9%, while HF Group was the farthest at 90.7%

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. I&M Holdings had the lowest cost to income ratio of 51.7%, while HF Group had the highest ratio at 113.5%

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 0.2x, while Equity Group is the most overvalued at 1.8x

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 17.3%, while NBK was the least solvent at 5.1%

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 Bank had the highest quality loan book with a gross non-performing loans ratio of 7.2%, while NBK had the highest non-performing loans ratio at 47.1%

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 74.2%, while Co-operative Bank has the lowest at 36.8%

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 46.5%, while DTBK has the lowest at 21.7%

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

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

Cytonn

Tier 1 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
KCB Group	• Increased channeled diversification which include mobile and agency banking. This is likely to help the bank to continue improving its operational efficiency and in effect improve the cost to income ratio by cost rationalization and NFI expansion • Improving asset quality, with the NPL ratio improving to 7.6% from 7.8% in Q3'2017, mainly attributed to an improvement in the corporate as well as the SME and Micro loan books	• Despite an investments in the alternative channels growth in Non Funded Income has remained muted having remained relatively flat in Q1'2018 and H1'2018 and only marginally picking up by 3.0% in Q3'2018, which has seen contribution of NFIs to total income only improving slightly to 33.1% as at Q3'2018 from 32.9% in Q3'2017, compared to an industry average of 34.5%
Equity Group Holdings	• 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	• The bank has experienced declining non-funded revenue, which may inhibit the banks growth if sustained for long periods of time, with management indicating they are not monetizing their alternative channels, as they build profile
Co-operative Bank	• It has a large Sacco banking base, and the opportunity to grow upon the model • Branch Transformation and deepening financial inclusion through alternative channels which will continue to drive NFI growth as well as transform braches to handle advisory, wealth management and advisory services	• Exposure to different political, economic and regulatory environments especially the impact of South Sudan operations • The bank's asset quality has been deteriorating consistently for the last 3 quarters, raising concerns of possible increments in the cost of risk
Standard Chartered	• Continued focus on promoting the usage of the bank's alternative channels. • The bank could diversify on its funding base to aid the bank in matching its issued loans tenor to its funding	• 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	• Barclays' NFI is improving as the bank focuses on digital innovation and alternative banking channels in the wake of the rebranding move. These will go a long way to grow the bank's fee income, and,	• 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 • Increased branch network will help mobilize deposits from customers • Partnerships with Jubilee Insurance and local retailers to drive Non-funded income	• Stiff competition in the SME banking market from established players like Equity, Co-op and KCB • Exposure to different political, economic and regulatory environments due to regional presence in various East African countries
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	• Political Instability in the countries they operate. The instability in S.Sudan proved to be a challenge as it affected their overall income • Their expansion strategy is limited by the presence of Standard Bank in the region

I. Equity Group Holdings

Financial Statements Extracts

Equity Group's PAT is expected to grow at a 5-year CAGR of 16.5%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	41.8	37.6	41.1	47.1	53.3
Non Funded Income	22.2	27.6	25.7	31.8	35.9
Loan Loss Provision	(6.6)	(3.4)	(2.0)	(3.1)	(3.5)
Other Operating Expenses	(32.5)	(34.8)	(34.8)	(38.7)	(42.7)
Total Operating Expenses	**(39.1)**	**(38.3)**	**(36.8)**	**(41.8)**	**(46.2)**
Profit Before Tax	24.9	26.9	30.1	37.1	43.0
Profit After tax	16.6	18.9	21.1	26.0	30.1
% PAT Change YoY	**(4.2%)**	**14.0%**	**11.3%**	**23.4%**	**15.8%**
EPS	4.4	5.0	5.6	6.9	8.0
DPS	2.0	2.0	2.0	2.0	2.0
Cost to Income	61.1%	58.7%	55.0%	53.0%	51.8%
NIM	11.1%	8.9%	8.3%	8.8%	8.8%
ROaE	21.5%	21.6%	22.7%	23.1%	22.6%
ROaA	3.7%	3.8%	4.0%	4.2%	4.3%

Balance Sheet	2016	2017	2018e	2019e	2020e
Net Loans and Advances	266.1	279.1	292.3	328.5	373.1
Government Securities	100.6	128.0	135.8	150.1	172.0
Other Assets	107.1	117.4	157.3	175.4	187.6
Total Assets	**473.7**	**524.5**	**585.4**	**654.0**	**732.7**
Customer Deposits	337.2	373.1	413.1	462.7	518.2
Other Liabilities	54.5	58.2	68.1	68.7	69.4
Total Liabilities	**391.7**	**431.3**	**481.2**	**531.4**	**587.6**
Shareholders Equity	82.0	93.1	103.3	121.8	144.3
Book value Per share	21.7	24.7	27.4	32.3	38.2
% Change in BPS YoY	**13.6%**	**13.6%**	**10.9%**	**17.8%**	**18.5%**

Financial Statements Extracts

Equity Group is undervalued with a potential upside of 72.8%

Cost of Equity Assumptions:	13-Dec-18
Default Spread Adjusted Risk free rate	13.2%
Beta	1.26
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	19.7%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	18.4%
Return on Average Equity 2022	23.9%
Justified Price to Book value per share	2.0x
Shareholder Equity - FY22e	209.83
Terminal Value-(Year 2022)	445.05

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intergrated DDM	87.3	40.0%	34.9
Residual Income	67.8	35.0%	23.7
PBV Multiple	26.8	20.0%	5.4
PE Multiple	36.6	5.0%	1.8
Fair Value			**65.8**
Current Price			**39.3**
Upside/(Downside)			67.7%
Dividend Yield			5.1%
Total Potential Return			**72.8%**

** 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 12.1%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	47.0	48.4	50.1	54.8	59.2
Non Funded Income	22.5	23.0	23.6	27.4	29.7
Loan Loss Provision	3.8	5.9	2.8	5.0	5.4
Other Operating Expenses	36.6	36.4	37.5	40.1	42.4
Total Operating Expenses	**40.4**	**42.3**	**40.4**	**45.1**	**47.8**
Profit Before Tax	29.1	29.1	33.4	37.1	41.1
Profit After tax	19.7	19.7	23.3	26.0	28.8
% PAT Change YoY	**0.5%**	**(0.1%)**	**18.5%**	**11.2%**	**10.7%**
EPS	6.4	6.4	7.6	8.5	9.4
DPS	3.0	3.0	3.6	4.0	4.5
Cost to Income	58.1%	59.2%	54.7%	54.9%	53.8%
ROE	22.2%	19.5%	20.9%	32.5%	26.1%
ROA	3.4%	3.2%	3.6%	5.8%	4.9%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	385.7	422.7	442.6	469.1	511.3
Government Securities	40.5	38.3	34.0	38.3	44.4
Other Assets	169.0	185.7	227.1	260.0	282.1
Total Assets	**595.2**	**646.7**	**703.8**	**767.4**	**837.8**
Customer Deposits	448.2	499.5	537.4	585.7	639.6
Other Liabilities	50.5	41.2	48.6	50.0	51.7
Total Liabilities	498.7	540.7	586.0	635.8	691.3
Shareholders Equity	96.6	106.0	117.8	131.6	146.6
Book value Per share	31.5	34.6	38.4	42.9	47.8
% Change in BPS YoY	**18.8%**	**9.7%**	**11.2%**	**11.7%**	**11.4%**

Valuation Summary

KCB Group is undervalued with a total potential return of 68.3%

Cost of Equity Assumptions:	13-Dec-18
Risk free rate *	13.2%
Beta	0.9
Country 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	18.2%
Justified Price to Book value per share	1.4x
Shareholder Equity - FY22e	180.5
Terminal Value - (Year 2022)	273.7

Valuation Summary	Implied Price	Weighting	Weighted Value
Residual Income	60.9	35%	21.3
PBV Multiple	44.8	20%	9.0
PE Multiple	53.8	5%	2.7
DDM Integrated	77.5	40%	31.0
Target Price			**64.0**
Current Price			**39.8**
Upside/(Downside)			60.7%
Dividend Yield			7.5%
Total Return			**68.3%**

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

III. Co-operative Bank

Financial Statements Extracts

Co-op's PAT is expected to grow at a 5-year CAGR of 7.5%

Income Statement	2016	2017	2018f	2019f	2020f
Net Interest Income	29.5	28.0	30.1	32.0	35.7
Non Funded Income	12.8	13.4	14.8	16.2	17.7
Loan Loss Provision	2.6	1.8	1.8	2.0	2.2
Other Operating Expenses	22.0	21.6	24.4	26.6	29.1
Total Operating Expenses	24.6	23.4	26.2	28.5	31.2
Profit Before Tax	17.7	18.0	18.8	19.8	22.3
Profit After tax	12.7	12.6	13.1	13.9	15.6
% PAT Change YoY	**8.3%**	**(0.4%)**	**4.0%**	**5.8%**	**12.6%**
EPS	2.6	2.6	2.7	2.8	3.2
DPS	1.0	1.0	1.1	1.1	1.3
Cost to Income	58.3%	56.6%	58.4%	59.1%	58.4%
NIM	**9.9%**	**8.5%**	**8.3%**	**8.3%**	**8.5%**
ROE	22.7%	19.5%	18.2%	17.3%	17.6%
ROA	3.7%	3.3%	3.1%	3.1%	3.2%

Balance Sheet	2016	2017	2018f	2019f	2020f
Net Loans and Advances	236.9	251.7	269.3	294.4	323.8
Government Securities	37.2	53.0	51.8	55.9	59.6
Other Assets	77.8	104.3	114.4	116.4	117.3
Total Assets	**351.9**	**409.0**	**435.5**	**466.8**	**500.7**
Customer Deposits	260.2	303.5	321.7	344.2	368.3
Other Liabilities	30.6	36.6	36.9	37.4	37.9
Total Liabilities	**290.7**	**340.1**	**358.6**	**381.6**	**406.2**
Shareholders Equity	61.3	68.1	76.0	84.4	93.7
Book value Per share	12.5	13.9	15.5	17.3	19.2
% Change in BPS YoY	**22.1%**	**11.1%**	**11.6%**	**11.0%**	**11.1%**

Valuation Summary

Co-operative Bank is undervalued with a total potential upside of 39.5%

Cost of Equity Assumptions:	13-De- 2018
Default Spread Adjusted Risk free rate	13.2%
Beta	1.5
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.8%
Cost of Equity	22.0%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	19.3%
Return on Average Equity 2022	18.3%
Terminal Price to Book value per share	1.5x
Shareholder Equity - FY22e	104.6
Terminal Value-(Year 2022)	164.2

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	23.5	40%	9.4
Residual income	17.4	35%	6.1
PBV Multiple	15.8	20%	3.2
PE Multiple	14.4	5%	0.7
Target Price			**19.4**
Current Price			**14.5**
Upside/(Downside)			34.0%
Dividend Yield			5.5%
Total Return			**39.5%**

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

IV. Standard Chartered Bank Kenya Ltd

Cytonn

Financial Statements Extracts

SCBK's PAT is expected to grow at a 5-year CAGR of 6.9%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	19.4	18.6	19.4	18.1	18.9
Non Funded Income	8.6	8.8	9.5	9.2	9.8
Loan Loss Provision	2.2	4.2	3.0	3.1	3.2
Other Operating Expenses	12.5	13.1	13.6	13.3	13.8
Total Operating Expenses	**14.7**	**17.3**	**16.6**	**16.4**	**17.0**
Profit Before Tax	13.3	10.1	12.3	10.9	11.7
Profit After tax	9.1	6.9	8.6	7.6	8.2
% PAT Change YoY	**42.7%**	**(23.6%)**	**24.3%**	**(11.1%)**	**7.3%**
EPS	26.3	20.1	25.0	22.2	23.9
DPS	20.0	17.0	17.0	16.7	17.9
Cost to Income	52.5%	63.2%	57.4%	60.1%	59.2%
NIM	9.6%	7.9%	8.0%	7.9%	7.9%
ROaE	21.3%	15.4%	18.1%	15.1%	15.6%
ROaA	3.7%	2.6%	3.0%	2.6%	2.7%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	122.7	126.3	111.8	115.0	122.1
Government Securities	86.9	110.5	106.0	109.2	115.9
Other assets	40.7	48.9	69.5	69.8	70.3
Total Assets	**250.3**	**285.7**	**287.3**	**294.0**	**308.3**
Customer Deposits	186.6	213.3	215.1	219.4	230.3
Other Liabilities	19.8	26.7	22.8	23.2	24.4
Total Liabilities	**206.4**	**240.1**	**237.8**	**242.6**	**254.8**
Shareholders Equity	43.9	45.7	49.5	51.4	53.5
Book value Per share	127.8	132.9	144.1	149.7	155.7
% Change in BPS YoY	**6.4%**	**4.0%**	**8.4%**	**3.9%**	**4.0%**

Valuation Summary

SCBK is undervalued with a total potential upside of 23.4%

Cost of Equity Assumptions:	13-Dec-18
Default Spread Adjusted Risk free rate	13.3%
Beta	0.8
Mature Market Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	17.5%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.5%
Return on Average Equity 2022	17.3%
Justified Price to Book value per share	1.7x
Shareholder Equity - FY22e	58.11
Terminal Value-(Year 2022)	105.8

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	251.7	40%	100.7
Residual Income	220.6	35%	77.2
PBV Multiple	167.7	20%	33.5
PE Multiple	168.5	5%	8.4
Target Price			**219.9**
Current Price			**192.0**
Upside/(Downside)			14.5%
Dividend Yield			8.9%
Total Return			**23.4%**

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

V. Diamond Trust Bank Kenya

Financial Statement Extracts

DTB has an estimated 5-year PAT CAGR of 9%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	19.4	19.7	20.4	22.3	22.7
Non Funded Income	5.1	5.3	5.4	5.5	6.0
Loan Loss Provision	(4.3)	(4.3)	(3.8)	(4.1)	(4.4)
Other Operating Expenses	(9.2)	(10.6)	(11.2)	(12.2)	(12.9)
Total Operating Expenses	**(13.5)**	**(14.9)**	**(15.0)**	**(16.4)**	**(17.3)**
Profit Before Tax	11.0	10.1	10.8	11.5	11.3
Profit After tax	7.7	6.9	7.6	8.1	7.9
% PAT Change YoY	**17.0%**	**(10.3%)**	**9.1%**	**6.7%**	**(1.5%)**
EPS	27.6	24.8	27.0	28.8	28.4
DPS	2.6	2.6	2.7	2.9	2.8
Cost to Income	(37.6%)	(42.3%)	(43.6%)	(43.9%)	(45.0%)
NIM	7.4%	6.5%	6.2%	6.3%	5.9%
ROaE	20.5%	14.4%	14.1%	13.6%	11.9%
ROaA	2.6%	2.0%	1.9%	1.9%	1.7%
Balance Sheet	**2016e**	**2017**	**2018e**	**2019f**	**2020f**
Net Loans and Advances	186.3	196.0	200.4	213.2	229.6
Government Securities	92.8	114.4	125.4	137.5	152.9
Other Assets	49.0	52.9	59.5	73.5	89.0
Total Assets	**328.0**	**363.3**	**385.3**	**424.3**	**471.4**
Customer Deposits	238.1	266.2	286.4	320.8	359.3
Other Liabilities	44.1	43.4	40.7	38.5	40.4
Total Liabilities	**282.2**	**309.7**	**327.2**	**359.3**	**399.7**
Shareholders Equity	41.0	48.4	53.0	59.9	66.6
Book value Per share	146.7	173.0	189.7	214.2	238.3
% Change in BPS YoY	**20.2%**	**17.9%**	**9.6%**	**12.9%**	**11.3%**

Valuation Summary

DTB’s stock is undervalued with a total potential return of 58.0%

Cost of Equity Assumptions:	13-Dec-18
Risk free rate *	13.30%
Beta	0.7
Country Risk Premium	5.2%
Extra Risk Premium	1.5%
Cost of Equity	18.06%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	20.0%
Return on Average Equity 2022	12.0%
Terminal P/B	1.2x
Shareholder Equity - FY22e	81.2
Terminal Value-(Year 2022)	102.8

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	231.1	40.0%	92.5
Residual Income	224.8	35.0%	78.7
PBV Multiple	255.8	20.0%	51.2
PE Multiple	178.7	5.0%	8.9
Target Price			**231.2**
Current Price			**148.0**
Upside/(Downside)			56.2%
Dividend yield			1.8%
Total return			**58.0%**

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

VI. Barclays Bank Kenya

Cytonn

Financial Statements Extracts

Barclays Bank's PAT is expected to grow at a 5-year CAGR of 6.3%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	22.3	21.8	22.6	24.8	26.4
Non Funded Income	9.3	8.5	9.1	10.4	11.3
Total Operating Income	**31.7**	**30.3**	**31.7**	**35.2**	**37.7**
Loan Loss Provision	(3.9)	(3.1)	(3.0)	(3.9)	(4.1)
Other Operating Expenses	(16.9)	(16.8)	(17.9)	(20.1)	(21.6)
Total Operating Expenses	**(20.8)**	**(19.9)**	**(20.9)**	**(24.0)**	**(25.7)**
Profit Before Tax	10.9	10.4	10.8	11.2	12.0
Profit After tax	**7.4**	**6.9**	**7.1**	**7.4**	**7.9**
% PAT Change YoY	**(11.9%)**	**(6.4%)**	**2.7%**	**4.0%**	**7.2%**
EPS	1.4	1.3	1.3	1.4	1.5
DPS	1.0	1.0	1.0	1.0	1.0
Cost to Income	65.7%	65.8%	66.0%	68.2%	68.2%
NIM	10.5%	9.7%	9.2%	9.1%	9.1%
ROaE	18.0%	16.0%	16.1%	16.3%	16.7%
ROaA	3.0%	2.7%	2.6%	2.5%	2.6%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	168.5	168.4	177.1	190.4	204.7
Government Securities	48.7	58.5	75.6	81.2	87.3
Other Assets	42.5	44.3	79.0	79.6	80.6
Total Assets	**259.7**	**271.2**	**331.6**	**351.2**	**372.6**
Customer Deposits	178.2	186.0	224.2	241.0	259.1
Other Liabilities	39.1	41.1	63.1	63.9	64.8
Total Liabilities	**217.3**	**227.1**	**287.3**	**304.9**	**323.9**
Shareholders Equity	42.4	44.1	44.4	46.3	48.8
Book value Per share	7.8	8.1	8.2	8.5	9.0
% Change in BPS YoY	**6.7%**	**4.0%**	**0.6%**	**4.4%**	**5.4%**

Valuation Summary

Barclays is undervalued with a total potential upside of 37.7%

Cost of Equity Assumptions:	13-Dec-18
Risk free rate	13.3%
Beta	0.9
Country Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	19.1%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	18.5%
Return on Average Equity 2022	17.9%
Terminal Price to Book value per share	1.6x
Shareholder Equity - FY22e	55.8
Terminal Value-(Year 2022)	96.5

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	12.0	40%	4.8
Residual Income	19.0	35%	6.7
PBV Multiple	10.0	20%	2.0
PE Multiple	8.7	5%	0.4
Target Price			**13.9**
Current Price			**10.8**
Upside/(Downside)			28.5%
Dividend Yield			9.3%
Total Return			**37.7%**

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

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

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	132.6	143.3	163.1	175.4	192.4
Other Assets	82.1	105.5	121.7	123.8	129.4
Total Assets	**214.7**	**248.7**	**284.8**	**299.1**	**321.8**
Customer Deposits	155.8	193.4	217.9	233.2	249.5
Borrowings	4.0	4.0	7.0	7.0	7.0
Other Liabilities	14.7	8.4	18.6	15.0	18.1
Total Liabilities	**174.5**	**205.8**	**243.6**	**255.2**	**274.6**
Shareholders Equity	40.1	43.0	41.3	43.9	47.1
Book value Per share	101.5	108.7	104.4	111.1	119.2
% Change in BVPS	**4.6%**	**7.0%**	**-3.9%**	**6.5%**	**7.3%**

Valuation Summary

Stanbic Holdings is undervalued with a total potential upside of 17.3%

Cost of Equity Assumptions:	13-Dec-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%
Mature Company Beta	1.00
Terminal Cost of Equity	19.4%
Return on Average Equity 2022f	12.0%
Justified Price to Book value per share	1.2x
Shareholder Equity - FY22e	57.20
Terminal Value-(Year 2022)	69.99

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	114.2	40%	45.7
Residual Income	114.1	35%	39.9
PBV Multiple	66.8	20%	13.4
PE Multiple	73.1	5%	3.7
Target Price			**102.7**
Current Price			**92.0**
Dividend Yield			**5.7%**
Upside/(Downside)			**17.3%**

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

B. Tier II Banks

Tier 2 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
NIC Group	• Increased investment in digital platforms, NIC Now and Internet banking • NIC Group has maintained its pole position in asset financing and curved a niche in the market • The possible merger with CBA presents opportunities for synergies in digital banking and lending activities due to a broad potential customer base	• Traditional SME market now being targeted by Tier 1 banks, hence it's market share is under threat • High cost of funds above Tier I and II average due to the bank mobilizing expensive deposits from customers
I&M Holdings	• The Bank has been aggressively expanding into other regions namely Tanzania, Rwanda and Uganda. • They have also fully embraced internet bank in Kenya to further help drive their efficiency	• The bank had a deterioration in asset quality with Gross Non-performing loans rising • They face stiff competition for clients from larger existing tier 1 bank in the SME and Retail sectors
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 enhance its operational efficiency as well as 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
National Bank of Kenya	• 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 well below the regulatory requirement, with their major shareholders slow to their commitments to inject additional capital in order to meet the statutory capital requirements. This may affect the bank's continuity, as may be unable to issue new loan, and find it hard to mobilize deposits

C. Tier II Banks

I. I&M Holdings

Financial Statement Extracts

I&M Holdings PAT is expected to grow at a 5-year CAGR of 8.0%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	15.5	15.6	18.0	21.7	24.3
Non- Funded Income	5.2	5.8	6.5	7.0	7.6
Total Operating Income	**20.8**	**21.3**	**24.4**	**28.8**	**31.9**
Loan Loss Provision	3.0	4.1	1.9	2.1	2.2
Other Operating Expenses	7.2	7.8	8.9	10.0	11.3
Total Operating Expenses	**10.2**	**12.0**	**10.8**	**12.1**	**13.5**
Profit Before Tax	10.6	9.9	14.1	17.1	18.9
Profit After Tax	7.8	7.3	9.9	12.0	13.2
EPS	18.6	16.4	23.9	29.0	32.0
% PAT Change YoY	**8.6%**	**(6.4%)**	**36.0%**	**21.3%**	**10.3%**
EPS	18.6	16.4	23.9	29.0	32.0
DPS	3.5	3.5	3.5	3.5	3.5
CIR	48.9%	56.2%	44.3%	42.2%	42.4%
NIM	8.6%	7.8%	7.8%	8.4%	8.8%
ROaE	21.3%	16.6%	21.0%	21.7%	19.9%
ROaA	3.6%	3.0%	3.7%	3.9%	3.9%
Balance Sheet	**2016**	**2017**	**2018e**	**2019f**	**2020f**
Investment Securities	45.8	50.8	44.3	47.8	51.6
Net Loans and Advances	134.7	153.0	167.6	180.5	192.5
Other Assets	30.1	36.2	83.7	94.2	108.5
Total Assets	**210.5**	**240.1**	**295.6**	**322.5**	**352.6**
Customer Deposits	146.5	169.3	212.2	228.5	246.8
Other Liabilities	24.5	23.8	30.8	30.8	30.8
Total Liabilities	**171.0**	**193.1**	**243.0**	**259.3**	**277.6**
Shareholders Equity	37.0	44.3	49.9	60.5	72.2
Book Value Per Share	94.4	107.2	120.7	146.2	174.7
% BVPS Change YoY	**17.7%**	**13.6%**	**12.6%**	**21.1%**	**19.5%**

Valuation Summary

I&M Holdings is undervalued with a total potential return of 67.4%

Cost of Equity Assumptions:	13-Dec-18
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	1.0
Terminal Cost of Equity	18.9%
Return on Average Equity 2022	13.3%
Justified Price to Book value per share	1.2x
Shareholder Equity - FY22e	84.9
Terminal Value-(Year 2022)	108.0

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	203.7	40%	81.5
Residual income	160.3	35%	56.1
PBV Multiple	101.0	20%	20.2
PE Multiple	99.3	5%	5.0
Target Price			**138.6**
Current Price			**85.0**
Upside/(Downside)			63.1%
Dividend yield			4.3%
Total return			**67.4%**

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

II. NIC Group

Financial Statement Extracts

NIC Group’s PAT is expected to grow at a CAGR of 5%

Income Statement	2017	2018e	2019f	2020f	2021f
Net Interest Income	10.8	10.7	10.8	11.8	12.7
Non Funded Income	4.2	4.3	4.4	4.9	5.3
Loan Loss Provision	3.0	2.7	3.0	3.4	3.8
Total Operating Expenses	9.3	9.4	9.9	10.7	11.8
Profit Before Tax	5.6	5.6	5.3	6.0	6.2
Profit After tax	4.1	3.9	3.7	4.2	4.3
% PAT Change YoY	**(4.3%)**	**(5.6%)**	**(4.3%)**	**11.9%**	**3.2%**
EPS	6.5	6.1	5.8	6.5	6.8
DPS	1.0	1.1	1.1	1.1	1.1
Cost to Income	62.5%	62.7%	64.8%	64.1%	65.6%
NIM	6.3%	5.8%	5.8%	5.8%	5.8%
ROE	12.9%	11.0%	9.8%	10.1%	9.6%
ROA	2.2%	1.9%	1.7%	1.8%	1.7%
Balance Sheet	**2017**	**2018e**	**2019f**	**2020f**	**2021f**
Net Loans and Advances	119.8	114.2	124.1	134.1	144.8
Government Securities	54.2	56.4	60.9	65.7	71.0
Other Assets	32.2	39.7	35.3	42.9	45.0
Total Assets	**206.2**	**210.3**	**220.3**	**242.7**	**260.8**
Customer Deposits	138.9	146.4	158.1	170.8	184.4
Other Liabilities	32.5	26.8	22.1	28.3	29.1
Total Liabilities	**171.5**	**173.2**	**180.2**	**199.1**	**213.5**
Shareholders Equity	34.2	36.7	39.7	43.2	46.8
Book value Per share	7.03	7.52	8.15	8.86	9.61
% Change in BVPS	**14.8%**	**7.1%**	**8.3%**	**8.8%**	**8.4%**

Valuation Summary

NIC Group is undervalued with a total potential return of 55.8%

Cost of Equity Assumptions:	13-Dec-18
Risk free rate *	13.20%
Beta	0.9
Country Risk Premium	5.2%
Extra Risk Premium	0.0%
Cost of Equity	17.8%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	18.4%
Return on Average Equity 2022	10.9%
Terminal Price to Book	0.9x
Shareholder Equity - FY22e	41.8
Terminal Value-(Year 2022)	39.9

Valuation Summary	Implied Price	Weighting	Weighted Value
DDM Integrated	43.7	40%	17.5
Residual Valuation	36.7	35%	12.8
PBV Multiple	44.5	20%	8.9
PE Multiple	30.0	5%	1.5
Target Price			**40.7**
Current Price			**26.8**
Upside/(Downside)			52.1%
Dividend Yield			3.7%
Total Potential Return			**55.8%**

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

III. 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	2019f	2020f
Net Interest Income	3.9	3.0	2.4	2.4	2.4
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)	(3.5)	(3.2)	(3.3)
Total Operating Expenses	**(3.3)**	**(4.0)**	**(4.2)**	**(3.8)**	**(4.0)**
Profit Before Tax	1.4	0.3	(0.3)	0.05	0.01
Profit After tax	0.9	0.1	(0.2)	0.03	0.004
% PAT Change YoY					**(85.9%)**
EPS	2.6	0.4	(0.5)	0.1	0.0
DPS	0.5	0.4	0.1	0.1	0.1
Cost to Income	56.3%	78.9%	89.9%	82.8%	82.8%
NIM	6.5%	5.2%	4.4%	4.6%	4.6%
ROaE	8.3%	1.1%	(1.7%)	0.3%	0.0%
ROaA	1.3%	0.2%	(0.3%)	0.0%	0.0%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	54.5	49.6	46.4	47.9	50.0
Government Securities	4.1	2.3	2.6	2.8	3.1
Other Assets	13.4	15.6	14.8	15.1	14.6
Total Assets	**71.9**	**67.5**	**63.8**	**65.8**	**67.8**
Customer Deposits	38.1	36.7	35.0	36.9	39.0
Other Liabilities	22.6	19.4	17.9	17.9	17.9
Total Liabilities	**60.6**	**56.1**	**52.9**	**54.8**	**56.9**
Shareholders Equity	11.3	11.4	10.9	10.9	10.9

Valuation Summary

HF Group is undervalued with a total potential return of 29.1%

Cost of Equity Assumptions:	13-Dec-18
Risk free rate *	13.2%
Beta	0.98
Country Risk Premium	5.2%
Extra Risk Premium	1.5%
Cost of Equity	20.6%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.0
Terminal Cost of Equity	20%
Return on Average Equity	0.5%
Terminal Price to Book	0.6x
Shareholder Equity - FY22e	9.9
Terminal Value-(Year 2022)	5.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	10.8	40%	4.3
Residual Income	1.0	35%	0.4
PTBV Multiple	8.0	20%	1.6
PE Multiple	12.0	5%	0.6
Fair Value			**6.87**
Current Price			**5.4**
Upside/(Downside)			27.2%
Dividend Yield			1.9%
Total return			***29.1%***

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

VII. National Bank of Kenya

Financial Statements Extracts

National Bank's PAT is expected to grow at a 5-year CAGR of 3%

Income Statement	2016	2017	2018e	2019f	2020f
Net Interest Income	7.8	6.7	6.5	6.8	7.3
Non Funded Income	2.9	2.4	2.2	2.1	2.3
Loan Loss Provision	2.4	0.8	0.5	0.7	0.8
Other Expenses	8.2	7.6	7.8	8.0	8.4
Total Operating Expenses	**10.6**	**8.4**	**8.3**	**8.7**	**9.2**
Profit Before Tax	0.1	0.8	(0.1)	0.3	0.4
Profit After tax	**0.1**	**0.4**	**(0.1)**	**0.2**	**0.3**
% PAT Change YoY		**479.0%**			**54.5%**
EPS	0.2	1.2	(0.2)	0.5	0.8
DPS	-	-	-	-	-
Cost to Income	76.6%	83.2%	89.5%	89.2%	87.8%
NIM	8.2%	7.4%	7.2%	7.3%	7.6%
ROaE	0.8%	5.8%	(1.1%)	2.7%	4.0%
ROaA	0.1%	0.4%	(0.1%)	0.2%	0.2%

Balance Sheet	2016	2017	2018e	2019f	2020f
Net Loans and Advances	55.0	52.4	46.5	47.0	48.6
Government Securities	34.5	35.7	41.8	46.0	46.7
Other Assets	22.5	21.8	24.5	21.5	21.4
Total Assets	112.1	109.9	112.9	114.5	116.7
Customer Deposits	93.9	94.3	93.0	93.9	95.3
Other Liabilities	11.3	8.4	13.0	13.5	14.0
Total Liabilities	105.2	102.6	106.0	107.4	109.4
Shareholders Equity	6.9	7.2	6.9	7.1	7.4
Book value Per share	20.4	21.4	20.3	20.9	21.7
% Change in BVPS	**(37.5%)**	**4.7%**	**(4.9%)**	**2.7%**	**4.1%**

Valuation Summary

National Bank is overvalued with a total potential downside of 12.1%

Cost of Equity Assumptions:	13-Dec-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	5.4%
Justified Price to Book value per share	0.39x
Preference Shares	5.68
Shareholder Equity - FY22e	8.1
Terminal Value-(Year 2022)	3.2

Valuation Summary:	Implied Price	Weighting	Weighted Value
Integrated DDM	3.33	40%	1.3
Residual Income	11.33	35%	4.0
PBV Multiple	4.29	20%	0.9
PE Multiple	3.68	5%	0.2
Target Price			**5.0**
Current Price			**5.7**
Upside/(Downside)			(12.1%)

Feedback Summary

During the preparation of this Q3'2018 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
KCB Group	Yes	Yes
I&M Holdings	Yes	Yes
National Bank Kenya	Yes	Yes
Standard Chartered Bank Kenya	Yes	Unresponsive
Housing Finance Group	Yes	Unresponsive
Stanbic Holdings	Yes	Unresponsive
Equity Group Holdings	Yes	Unresponsive
Barclays Bank of Kenya	Yes	Unresponsive
Cooperative Bank of Kenya	Yes	Unresponsive

Thank You!

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