I&M-holdings-plc-fy2019-earnings-note

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Valuation Summary

- We are of the view that I&M Holdings Plc is a "*BUY*" with a target price of Kshs 75.2, representing an upside of 51.0%, from the current price of Kshs 49.8 as of 27th March 2020, inclusive of a dividend yield of 5.1%,
- I&M Holdings Plc is currently trading at a P/TBV of 8x and a P/E of 4.0x vs an industry average of 1.2x and 6.1x, respectively.

Key Highlights FY

- The parent company I&M Holdings injected an additional Kshs 1.8 bn into the bank following the expansion of operations after the acquisition of Giro Commercial Bank in 2017. The bank joined the class of large banks after its market share grew by 0.5% points to 5.3%, thus surpassing the 5.0% benchmark used by the Central Bank of Kenya (CBK) to classify banks as large industry players. The growth in market share was driven by new business from its acquisition of Giro Bank.

Income Statement

- Core earnings per share increased by 26.6% to Kshs 13.0, from Kshs 10.3 (normalized EPS) in FY'2018, largely in line with our projections of a 28.2% increase to Kshs 13.2. The performance was driven by a 2.6% increase in total operating income, as well as a 17.8% decrease in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 2.6% rise in total operating income to Kshs 23.8 bn, from Kshs 23.2 bn in FY'2018, which was slower than our expectation of an 11.8% rise,
- Total operating income rose by 2.6% to Kshs 23.8 bn, from Kshs 23.2 bn in FY'2018. This was driven by a 9.1% increase in Non-Funded Income (NFI) to Kshs 8.3 bn, from Kshs 7.6 bn in FY'2018, offsetting the 0.5% decline in Net Interest Income (NII) to Kshs 15.5 bn, from Kshs 15.6 bn in FY'2018,
- Interest income rose by 4.5% to Kshs 27.2 bn, from Kshs 26.0 bn in FY'2018. This was driven by an 8.2% growth in interest income from loans and advances to Kshs 22.4 bn, from Kshs 20.7 bn in FY'2018. The yield on interest-earning assets, however, declined to 10.4%, from 11.2% in FY'2018, largely attributable to a decline in yields on government securities recording a decline of 17.0% to Kshs 4.1 bn from Kshs 5.0 bn in FY'2018 offsetting the 2.2% increase in average government securities to Kshs 53.0 bn from 51.9 bn in FY' 2018,
- Interest expense rose by 12.0% to Kshs 11.7 bn, from Kshs 10.4 bn in FY'2018, following a 14.6% increase in the interest expense on customer deposits to Kshs 10.1 bn, from Kshs 8.8 bn in FY'2018, offsetting the 7.2% decline in interest expense on placements to Kshs 542.6 mn, from Kshs 584.7 mn in FY'2018. Other interest expenses also increased by 1.0% to Kshs 1.03 bn from Kshs 1.02 mn in FY'2018. Despite the higher interest expenses, the cost of funds declined marginally to 4.8% from 4.9% in FY'2018, owing to a slower increase in interest-bearing liabilities that rose by 6.9% to Kshs 249.0 bn from Kshs 232.5 bn in FY'2018 that was outpaced by the growth in interest expense. Net Interest Margin (NIM) declined to 6.3%, from 7.6% in FY'2018

due to a 0.5% decline in NII offsetting the 12.7% increase in average interest-earning assets,

- Non-Funded Income rose by 9.1% to Kshs 8.3 bn, from Kshs 7.6 bn in FY'2018. The increase was mainly due to a 5.0% increase in fees and commissions on loans to Kshs 1.9 bn from Kshs 1.8 bn in FY'2018. In addition, the FX trading income increased marginally by 0.4% to Kshs 2.58 bn from Kshs 2.57 bn in FY'2018 while other income rose by 56.7% to Kshs 1.7 bn from Kshs 1.1 bn. The revenue mix shifted to 65:35 funded to non-funded income, from 67:33, owing to the growth in NFI, coupled with the decline in NII,
- Total operating expenses declined by 17.8% to Kshs 10.1 bn from Kshs 12.3 bn in FY'2018, largely driven by an 83.3% decline in Loan Loss Provisions (LLP) to Kshs 636.5 mn from Kshs 3.8 bn in FY'2018. There was however a 15.1% increase in staff costs to Kshs 4.7 bn from Kshs 4.1 bn in FY'2018,
- Owing to the 83.3% decline in Loan Loss Provisions (LLP), Cost to Income Ratio (CIR), with LLP improved to 42.4%, from 53.0% in FY'2018. Without LLP, the cost to income ratio deteriorated to 39.8% from 36.6% in FY'2018, an indication of reduced efficiency,
- Profit before tax rose by 27.0% to Kshs 14.6 bn, up from Kshs 11.5 bn in FY'2018. Profit after tax grew by 26.6% to Kshs 10.8 bn in FY'2019, from Kshs 8.5 bn in FY'2018, with the effective tax rate increasing to 34.2%, from 30.5% in FY'2018,
- The bank recommends a first and final dividend of Kshs 2.55 per share, which is a 30.8% increase from Kshs 1.95 per share paid in FY'2018, which translates to a dividend yield of 5.1% at the current price of Kshs 49.8 and a payout ratio of 19.6%.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 9.3% to Kshs 315.4 bn, from Kshs 288.5 bn in FY'2018. Growth was supported by a 20.5% increase in placements to Kshs 40.6 bn from Kshs 33.7 bn in FY'2018. The loan book also expanded by 5.2% to Kshs 175.3 bn from Kshs 166.7 bn in FY'2018, while Government securities rose by 3.4% to Kshs 53.9 bn from Kshs 52.2 bn in FY'2018,
- Total liabilities rose by 7.1% to Kshs 254.4 bn, from Kshs 237.6 bn in FY'2018, driven by a 7.6% increase in customer deposits to Kshs 229.7 bn from Kshs 213.1 bn in FY'2018. Deposits per branch increased by 5.2% to Kshs 5.5 bn from Kshs 5.2 bn in FY'2018, with the number of branches increasing by 1 to 42 branches. Borrowings declined by 21.1% to Kshs 10.9 bn, from Kshs 13.8 bn in FY'2018,
- The faster growth in deposits as compared to the growth in loans led to a decline in the loan to deposit ratio to 76.3% from 78.2% in FY'2018,
- Gross non-performing loans declined by 5.3% to Kshs 21.3 bn in FY'2019 from Kshs 22.5 bn in FY'2018. The NPL ratio, thus, improved to 11.3% in FY'2019 from 12.6% in FY'2018 attributable to a 5.3% decline in Non-Performing Loans, outpacing the 5.1% growth in gross loans. With general Loan Loss Provisions increasing by 7.6% to Kshs 8.6 bn from Kshs 8.0 bn in FY'2018, the NPL coverage improved to 59.1% in FY'2019 from 53.9% in FY'2018 despite the 5.3% decline in gross non-performing loans,
- Shareholders' funds increased by 20.6% to Kshs 57.7 bn in FY'2019, from Kshs 47.9 bn in FY'2018, supported by a 25.9% increase in retained earnings to Kshs 33.9 bn, from Kshs 26.9 bn,
- I&M Holdings Plc remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 17.3%, 6.8% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 21.2%, exceeding the statutory requirement by 6.7% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 17.2%, while total capital to risk-weighted assets came in at 21.0%.
- The bank currently has a Return on Average Assets (ROaA) of 3.4%, and a Return on Average Equity (ROaE) of 19.5%

Key Take-Outs:

1. The bank maintained its continued rise in NFI recording a 9.1% growth to Kshs 8.3 bn, from Kshs 7.6 bn in FY'2018. This resulted in the revenue contribution mix shifting to 65:35 funded to non-funded income, from 67:33, owing to the high growth in NFI that outpaced growth in NII. This, however, remains below the current industry average of 32.6% NFI,
2. The bank's asset quality improved, with the NPL ratio improving to 11.3%, from 12.6% in FY'2018. NPL coverage also improved to 59.1%, up from 53.9% in FY'2018 as the 7.6% rise in general provisions to Kshs 8.6 bn, from Kshs 8.0 bn in FY'2018, outpaced the 5.3% decline in gross NPL to Kshs 21.3 bn in FY'2019 from Kshs 22.5 bn in FY'2018, and,
3. There was a decline in efficiency levels as the cost to income ratio without LLP worsened to 39.8% from 36.6% in FY'2018. The deterioration was largely attributable to a 15.1% rise in staff cost, which depressed the bottom line.

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

i. Non-Funded Income Growth Initiatives – I&M Holdings' NFI growth is improving as the bank focuses on digital innovation to augment transaction volumes and increase fee income. The bank needs to increase the capacity of its brokerage and advisory businesses to increase income contribution from investment and advisory services, and,
ii. Geographical Diversification – The bank has been aggressively expanding into other regions, namely Tanzania, Rwanda, and Uganda. This is expected to drive growth in the near future.

Below is a summary of the bank's performance:

Balance Sheet	FY'18	FY'19	y/y change	FY' 2019 e	Expected y/y change	Variance in Actual Growth vs. Expected
Net Loans and Advances	163.4	175.3	7.3%	184.3	12.9%	(5.5%)
Total Assets	288.5	315.3	9.3%	338.8	17.4%	(8.2%)
Customer Deposits	213.1	229.7	7.8%	241.0	13.0%	(5.3%)
Total Liabilities	237.6	254,.4	7.1%	272.7	14.8%	(7.7%)
Shareholders' Funds	47.9	57.7	20.6%	63.0	31.6%	(11.0%)

Balance sheet ratios	FY'18	FY'19	% y/y change
Loan to Deposit Ratio	78.2%	76.3%	(1.9%)
Return on average equity	17.2%	19.5%	2.3%
Return on average assets	3.0%	3.4%	0.4%

Income Statement	FY'18	FY'19	y/y change	FY' 2019 e	Expected y/y change	Variance in Actual Growth vs. Expected
Net Interest Income	15.6	15.5	(0.5%)	20.2	29.4%	(30.0%)
Net non-Interest Income	7.6	8.3	9.1%	9.8	28.4%	(19.3%)
Total Operating income	23.2	23.8	2.6%	29.9	29.1%	(26.5%)
Loan Loss provision	(3.8)	(0.6)	(83.3%)	(4.4)	15.3%	(98.5%)
Total Operating expenses	(12.3)	(10.1)	(17.8%)	(15.1)	22.8%	(40.6%)

Income statement ratios	FY'18	FY'19	% y/y change
Yield from interest-earning assets	10.9%	10.4%	(0.5%)
Cost of funding	4.8%	15.2%	10.4%
Net Interest Margin	6.5%	5.9%	(0.6%)
Cost to Income	51.7%	42.4%	(9.2%)
Cost to Assets	2.2%	3.0%	0.8%
Net Interest Income as % of operating income	65%	65%	0.3%
Non-Funded Income as a % of operating income	35%	35%	(0.3%)

Capital Adequacy Ratios	FY'18	FY'19
Core Capital/Total Liabilities	20.2%	22.7%
Minimum Statutory ratio	8.0%	8.0%
Excess	12.2%	14.7%
Core Capital/Total Risk-Weighted Assets	15.3%	17.3%
Minimum Statutory ratio	10.5%	10.5%
Excess	4.8%	6.8%
Total Capital/Total Risk-Weighted Assets	16.9%	21.2%
Minimum Statutory ratio	14.5%	14.5%
Excess	2.4%	6.7%
Liquidity Ratio	47.8%	46.3%
Minimum Statutory ratio	20.0%	20.0%
Excess	27.8%	26.3%
Adjusted Core Capital/Total Liabilities	20.25%	20.2%
Adjusted Core Capital/Total RWA	15.31%	16.0%
Adjusted Total Capital/Total RWA	17.33%	19.5%