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STERLING CAPITAL LIMITED

Kenya Banks

FY2019 Earnings Update

February 2020

"Subdued performance on lower yields"

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For important disclosures refer to the disclosures section located at the end of this report.

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Executive Summary

- Our 2020 Full year 2019 (FY2019) earnings update report titled **"Subdued performance on lower yields"** gives a brief overview of the main macro-economic, regulatory and operational influences on the Kenyan banking sector in 2019 as well as a preview of our expectations of the financial performance of the nine banks under our coverage ahead of the earnings release.
- The first part of the report talks our report mentions in brief overall sector profitability growth expectations, interest rates, asset quality, liquidity, monetary policy, mergers and acquisitions, regulatory and overall banking strategy developments.
- The key development during the year was the repeal of the interest rate caps in November 2019 which however had minimal impact on earnings in consideration of the repeal late in the year.
- Further deterioration of asset quality is noted in the report as having a major impact on credit provision amongst banks.
- Corporate actions including the merger on NIC and CBA and the acquisition of National Bank of Kenya by KCB Bank Group was also another major factor during the year.
- Macro-economic factors such as interest rates and foreign exchange rates were largely stable during the year with a temporary fluctuation in currency value in the middle of the year due to the impact of demonetization.
- The second part of the report focuses on the FY2019 financial performance of the respective banks where we expect NCBA, Equity and Co-op to report strong after tax earnings with Standard Chartered and Diamond Trust expect to report modest growth over FY2018.
- Operational cost management, selective credit provision are expected to be the main themes amongst banks covered and this will be reflected in the FY2019 earnings.
- In spite of modest growth reported by our universe of banks, the repeal of the interest capping law, emphasis on operational cost management and banks' emphasis to grow Non interest income lines spells good prospects for the banking sector in 2020.

1) KENYA BANKING SECTOR 2019 REVIEW

- We expect the financial performance of the Kenya Banking sector in 2019 to be modest in terms of growth in profitability with most banks recording single digit growth over the previous year.
- The general poor performance of the economy is expected to have a negative impact on the overall financial performance of the banking sector in particular with reference to poor asset quality while interest rate caps on lending will adversely impact interest margins.
- We review in summary the major influences in the banking sector that forms the basis of our estimates for the soon to be released financial results.

A) Macro-economic Performance

- The slow-down in economic activity was evident during the year with data from the Kenya National Bureau of Statistics (KNBS) consistently showing lower quarterly economic growth in 2019 (5.6%, 5.6% and 5.1% for Q1 to 3 respectively compared to 6.5%, 6.4% and 6.4% for the same period in 2018).
- The negative impact of slow growth in private sector credit on private sector consumption and investment adversely affected overall economic activity which in turn we expect to impact the overall performance of the financial and banking sector in particular.
- Macro-economic factors such as inflation and foreign exchange rate remained well within the regulator's expectations and without extreme shock that would have affected the performance of the overall economy or the banking sector.
- With reference to fiscal policy and particularly public debt, an increase in a fiscal deficit and therefore domestic debt issues meant that banks continued to invest in Government securities, a reason that also explained the slow pace of private sector credit growth.

B) Overall Banking Sector profitability

- Overall we expect a modest growth in profitability in the range of 5-6% with the gains from increased loan book growth and interest spreads eroded by deteriorating asset quality and increase in operating expenses.
- Private sector credit growth improved to an average of 5.4% in 2019 compared to 3.4% in 2018. Our view is lending was largely selective to limit risk exposure with Stanbic, Equity and KCB expected to be the top lenders by growth rate amongst our universe of covered banks during the year.
- Positive for the players in the sector was the removal of interest rate caps on deposits in October 2018 that saw banks revise interest rates downwards with a positive impact on interest rate spreads and overall net interest margin.
- It was however a case of too little too late with reference to the impact of repeal of the law capping interest rates on commercial bank loans in November 2019 on interest margins.
- Either way, the removal of the cap has proved to be almost inconsequential so far as a combination of two downward revisions of the central Bank Rate (CBR) and persuasion of the CBK has since lending rates remain almost unchanged if not lower than under the interest rate capping regime.

C) Interest rates

- In general, we expect lower yields from both loans and advances as well as Government securities in 2019 compared to 2018 largely as a result of the impact of interest rate caps.
- With almost similar yields on both interest earning assets, banks are expected to have contrasting investment strategies as was the case of H1 2019 where Stanbic, Equity and CBA banks recorded faster loan book growth rates than holdings Government securities while KCB, Barclays, Co-op and NIC did the opposite.

Commercial Bank Interest Rates

- 2019 Average commercial banking lending rates declined to 12.4-12.5% compared to 13.1% in 2018 while interest rates on deposits rates declined to around 7% compared to 7.9% in 2018 a direct result of caps on deposits.
- Our analysis of the average yield on loans and advances in our universe of listed banks (with the exception of National Bank and Housing Finance) shows a yield of 11.1% in H1 2019 compared to 11.14% FY2018 both being a significant decline from the precap era FY2015 - 14.5%
- This trend resulted in an interest rate spread of about 5.4% compared to 5.2% the previous year.
- Note however the impact of lower yields will be minimal on account of increased lending by some banks and the increase in interest rate margins (due to lower deposit rates)

Domestic Debt Interest Rates

- Interest rates on domestic debt declined marginally during the year with an average decline of approximately 0.9%, 1.7% and 0.9% in the 91, 182 and 364 Day Treasury Bill rates respectively.
- This decline was also exhibited in the long term debt market with the yield curve shifting downwards in 2019 compared to the previous year.
- This was a direct result of the impact of interest rate caps that restricted private sector credit, high market liquidity and heavy Government borrowing in the domestic debt market.
- Declining domestic debt interest rates translates to a decline in average yields on Government securities.
- Our universe of listed banks had an average yield of 11.56% in 2018 and 11.45% as at H1 2019 this being lower than 12.05% FY2015.
- We see average yields on Government securities at between 11.5% and 11.8% with some banks returning more from their portfolio of Government securities compared to loans and advances.

D) Foreign Exchange Developments

- The Kenya Shilling remained largely stable during the year reporting a 0.5% and 2.7% appreciation against the United States Dollar (US.$)and the Euro whilst depreciating 2.9% against the Sterling Pound.
- There was a temporary depreciation in the local currency particularly against the US$ in the run up (June to September 2019) to the demonitisation of the old generation KES.1, 000 currency notes beginning 1st October 2019 with unusual demand for the US$ reported.
- This stabilized after the period with the local currency recouping some of its mid-year loses.
- We do not expect the demonetization to have a significant impact on commercial banks' earnings FY2019 although we expect to see an increase in both local and foreign currency deposits during the period under review.

E) Investment in Government securities

- Banks appetite for domestic debt has declined with financial data up to Q3 of 2019 showing a declining growth rate for some banks while others reduced their proportional holdings in favour of private sector lending.
- Stanbic Bank, I & M and NIC Banks showed a biggest decline in proportional holdings of Government securities in H12019 and we would expect a near similar trend for FY2019.
- Barclays and Co-op Bank showed recorded the biggest increase in proportion of holdings of Government securities in H1 2019.
- Our view is the trend was a direct result of declining interest rates on domestic debt and a growing imbalance in banks total investment asset mix that made it necessary for banks to slow down on investment in public debt.

F) Asset Quality

- Asset quality remains poor with sector Gross Non-Performing Loan ratio at 12.6% in 2019 compared to 12.1% in 2018.
- This poor asset quality is reflected in the slow pace of growth in loans and advances as adopted selective lending to limit risk exposure.
- We expect most of our covered banks to record a decline in loan loss provisions due to prudent lending evoked to limit loan loss exposure with a resulting positive impact on operating expenses and overall profitability.

G) Overall Banking Sector Liquidity

- Banking sector liquidity improved in 2019 with average banking sector liquidity at 50.5% compared to 47.4% the previous year.
- This was a direct result of subdued private sector lending growth and banks preference for investment in short-term Government securities, repo market activity and inter-bank lending.
- Monthly average Inter-bank lending rates stood at 4.3 in 2019 compared to 5.2% in 2018 with few sharp spurts showing improved liquidity especially amongst Tier 1 banks.

H) Monetary Policy

- Monetary policy remained unchanged for the better part of the year until November 2019 when the CBR was revised downwards for the first time since July 2018.
- It is our opinion that the revision of the benchmark rate to 8.5% from 9% was mainly influenced by market expectations of a rise in interest rates following the repeal of lending rate capping law with the regulator keen on increasing private sector credit growth.

I) Mergers & acquisitions

- The creation of NCBA following the merger of NIC ad Commercial Bank of Africa in and the acquisition of National Bank of Kenya (NBK) in are the two main corporate activities by banks in 2019.
- In terms of the financial impact of the merger and acquisition, FY2019 comes probably too soon to evaluate the effect.
- It is expected that NCBA will be a more formidable player in the banking sector with the biggest impact being on the bank's operations rather than profitability in the near and medium term.
- In the case of KCB, we remain concerned on the potential negative impact of NBK's poor asset book and operational inefficiencies on the financial and operational performance of the group in the medium term.

J) Regulation

- The single biggest regulatory intervention in the sector was the removal of interest rate caps on lending and bank supervision which is for the benefit of the sector in the long run.
- Banks particularly those in the top tier continued to enjoy a decline in interest expense following the removal of caps on deposits in the previous year.
- As mentioned earlier, the repeal of the law on interest rates will have little effect on banks performance FY2019.

K) Overall banking strategy

- The main factors in consideration here is bank investment strategy (loans or government securities, NFI growth and management of operational expenses.
- Loan book growth for the larger players in the sector was largely through digital platforms which also had a positive impact on overall efficiency and operational costs.
- Banks focus on NFI continued considering the limits imposed on interest income growth with NCBA and Co-op Banks expected to exhibit the biggest growth.
- With a limit on how they can grow the top line, banks continued to focus on how they can manage their operational costs with staff and service delivery costs a major focus.

2) KENYA BANKS' FY2019 FINANCIAL PERFORMANCE

1) KCB Group Plc

Balance Sheet

- Bank expected to report a 10.1% growth in total assets to KES.786.8Bn driven by 9.4% (KES.498.7Bn) and 6.8% (KES.128.3Bn) growth rates in loan book and holdings of Government securities respectively.
- Forecast 11% growth in customer deposits to KES.596.6Bn.

Income Statement

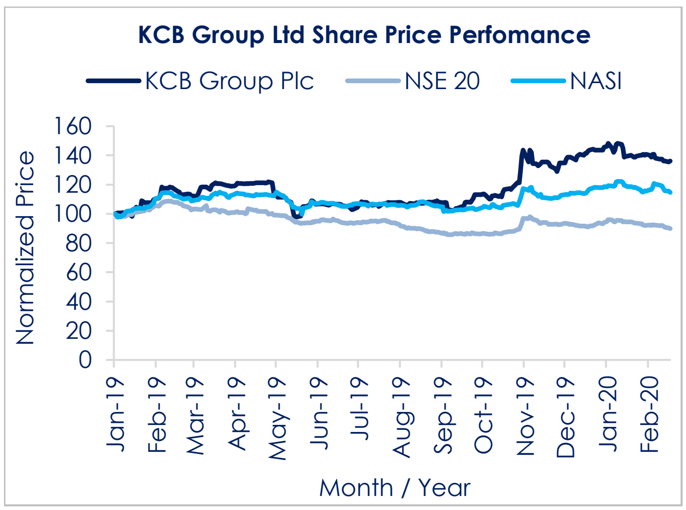
- FY2019 estimated Profit after Tax (PAT) growth is 4.6% to KES.25.1Bn.
- Total interest income growth of 4.7% to KES.69.5Bn boosted by 4.2% increase in interest income from loans and advances (KES.54.9Bn).
- Interest earnings from Government securities up 3.1% to KES.13.3Bn.
- Non Funded Income (NFI) driven by strong growth in fees and commission income estimated 9.6% up to KES.25.2Bn.
- A negative for the bank would be 11.2% increase in operating expenses FY2019 to KES.41.8Bn.
- Asset quality is fairly well managed and this should see an improvement in the Non-Performing Loan (NPL) ratio to 6.2% lower than 6.9% in 2018.

Investment Recommendation

- We are not overly concerned about the short term impact of the acquisition of National Bank as the two banks will operate as separate entities until 2021.
- Final dividend to remain at KES.2.50 contributing to a total dividend of KES.3.50 for FY2019.
- We maintain a **BUY** recommendation guided by our **fair value estimate of KES.63 with trailing P/E and P/B multiples of 6.4x and 1.3x** respectively against the industry averages of 7.1x and 1.2x.
- Our fair value estimate is an upside of 26% based on the current share price of KES.50.

Share Summary	
Fair Value Estimate (KES)	63
Recommendation	**BUY**
Current Price (KES)	50.00 (21-Feb-20)
Upside (%)	↑26
Price Change YOY (%)	↑19.2
Price Change YTD (%)	↓7.8
Dividend Yield (%)	7.0
Trailing P/E	6.4
Trailing P/B	1.3
Issued Shares (Mn)	3,213.5
Free Float (%)	73.1
Market Cap (KES.Bn)	160.7
NSE Code	KCB
Bloomberg Code	KNCB:KN

Source: Nairobi Securities Exchange & Sterling Capital Research



Source: Nairobi Securities Exchange & Sterling Capital Research

Key Financial Summary

	2018	2019E	% Change
Balance Sheet (KES.Bn)			
Loans & Advances	455.9	498.7	9.4
Government Securities	120.1	128.3	6.8
Total Assets	714.3	786.8	10.1
Customer Deposits	537.5	596.6	11.0
Income Statement (KES.Bn)			
Interest income (Loans & Advances)	52.7	54.9	4.2
Interest income (Gov't Securities)	12.9	13.3	3.1
Total Interest Income	66.3	69.4	4.7
Total Interest Expense	17.4	17.5	0.6
Net Interest Income	48.8	52.0	6.6
Non-Funded Income	23.0	25.2	9.6
Total Operating Income	71.8	77.1	7.4
Loan Loss Provisions	2.9	6.2	113.8
Total Operating Expenses	37.6	41.8	11.2
Profit After Tax	24.0	25.1	4.6
Ratios			
Cost to Income Ratio	50.4	50.1	0.3
NPL Ratio	6.9	6.2	0.7
Net Interest Margin	9.7	9.2	0.5
ROE	21.1	19.7	1.4

Source: Bank Filings & Sterling Capital Research

2) Equity Group Holdings Plc

Balance Sheet

- Expected to report the biggest growth in asset book FY2019 at 20.6% to KES.697.7Bn.
- Asset growth largely driven by 26.3% loan book expansion (KES.375.4Bn) and 11% growth in investments in Government securities (KES.179.8).
- The bank appears to have changed tact reducing the pace of growth in holdings of Government securities (FY2018 25.7%) in favour of private sector lending.
- FY2019 customer deposits to grow 18% to KES.498.9Bn.

Income Statement

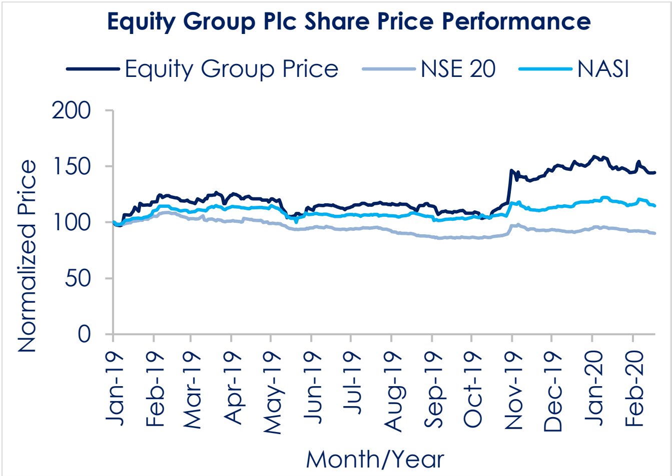
- Amongst our top picks on the basis of profitability with PAT at KES.23.1Bn a 17.1% growth over the previous year boosted by strong performances in in total interest and NFI.
- Total interest income up 10.8% to KES.58.7Bn attributable to 10.8% growth in income from loans and advances (KES.40.4Bn) as well as 9.4% increase in interest income from Government securities (KES.17.8Bn).
- NFI growth estimated at 12% to KES.29Bn on the back of increased forex trading income (+20.7%) as well as earnings from fees and commissions largely from digital banking platforms.
- In line with the bank's focus of managing operating costs we see a 7.1% increase to KES.37.6Bn driven mainly by 15% growth in staff costs.
- We however expect the superior growth in operating income to result in an improvement in its Cost to Income (CTI) ratio to 50.6% from 52.2% FY2018.
- The bank is expected to report a NPL ratio of 8.3% compared to 7.7% FY2018 due to aggressive loan book growth.

Investment Recommendation

- We expect an increase in the dividend payout to KES.2.50 per share on the basis of strong performance by the bank FY2019.
- We revise our recommendation from **BUY to HOLD** guided by our **fair value estimate of KES.54.35** with **trailing P/E and P/B multiples of 9.6x and 2x** respectively against the industry averages of 7.1x and 1.2x.
- The fair value estimate represents an upside of 9.8% based on the current share price of KES.49.50.

Share Summary	
Fair Value Estimate (KES)	54.35
Recommendation	**HOLD**
Current Price (KES)	49.50 (21-Feb-20)
Upside (%)	↑9.8
Price Change YOY (%)	↑18.3
Price Change YTD (%)	↓ 8.8
Dividend Yield (%)	4.0
Trailing P/E	9.6
Trailing P/B	2.0
Issued Shares (Mn)	3,773.7
Free Float (%)	71
Market Cap (KES. Bn)	189.63
NSE Code	EQTY
Bloomberg Code	EQBNK : KN

Source: Nairobi Securities Exchange & Sterling Capital Research



Source: Nairobi Securities Exchange & Sterling Capital Research

Key Financial Summary

	2018	2019E	% Change
Balance Sheet (KES.Bn)			
Loans & Advances	297.2	375.4	26.3
Government Securities	161.0	178.7	11.0
Total Assets	573.4	697.7	21.7
Customer Deposits	422.8	498.9	18.0
Income Statement (KES.Bn)			
Interest income (Loans & Advances)	36.4	40.4	10.8
Interest income (Gov't Securities)	16.3	17.8	9.4
Total Interest Income	53.2	58.7	10.3
Total Interest Expense	11.8	13.4	13.9
Net Interest Income	41.2	45.3	9.3
Non-Funded Income	25.9	29.1	10.6
Total Operating Income	67.3	74.4	10.6
Loan Loss Provisions	3.7	3.8	1.3
Total Operating Expenses	35.1	37.6	7.1
Profit After Tax	19.7	23.1	17.1
Ratios			
Cost to Income Ratio	52.2	50.6	1.6
NPL Ratio	7.7	8.3	0.6
Net Interest Margin	8.7	8.4	0.3
ROE	20.9	22.5	2.4

Source: Bank Filings & Sterling Capital Research

3) NCBA Group

Balance Sheet

- This is expected to be the first year of consolidated reporting by NCBA with total assets projected at KES.499.0Bn a 10% growth over FY2018, boosted by 6.0% and 7.5% increases in loan book and holdings of Government securities respectively.
- Loan book up 6% to KES.254Bn mainly attributable to lending via CBA's digital channels; M-Shwari and Fuliza.
- Investment in government securities estimated at KES.139.4Bn compared toKES.129.7Bn FY2018.
- The merged entity continues to leverage on its scale, market reach and digital channels with customer deposits projected to increase 11.9% to KES.381.6Bn.

Income Statement

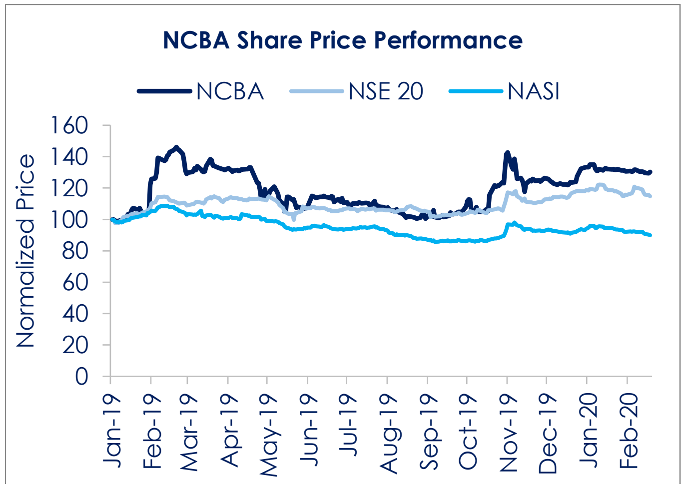
- The bank falls into our list of top performers FY2019 with PAT up 19.5% to KES.11.1Bn backed by 20% growth in NFI to KES.19.3Bn that offsets modest 2% growth in total interest income (KES.41.2Bn) due to lower yields on both loans and advances and Government securities.
- Our expectations of strong NFI growth are mainly a result of an increase in fees and commission income from digital lending.
- Operating expenses to increase 6.0% to KES.25.5Bn with a big portion of the increased expenses attributable to the merger.
- The Group's NPL ratio is high at 12% largely because of NIC's poor asset book quality, a slight improvement from 12.3% (assuming both entities had merged in 2018) FY2018 but still near the banking 12.6% industry average FY2019.

Investment Recommendation

- We predict an improved dividend of KES.1.50 from KES.1.25 issued FY2018.
- We give a **BUY** recommendation based on a fair value estimate of **KES.41.60** a 16.2% upside from the current market price of KES.35.80.
- The bank trades on a **trailing P/E of 5.8x and a P/B of 0.8x** against sector average P/E of 6.9x and P/B of 1.2x.

Share Summary	
Fair Value Estimate (KES)	41.60
Recommendation	BUY
Current Price (KES)	35.80 (21-Feb-20)
Upside (%)	↑16.2
Price Change YOY (%)	↓10.5
Price Change YTD (%)	↓2.8
Dividend Yield (%)	4.2%
Trailing P/E	4.8x
Trailing P/B	0.7x
Issued Shares (Mn)	1,497.7
Free Float (%)	50.9
Market Cap (KES. Bn)	53.6
NSE Code	NCBA
Bloomberg Code	NCBA:KN

Source: Nairobi Securities Exchange & Sterling Capital Research



Source: Nairobi Securities Exchange & Sterling Capital Research

Key Financial Summary

	2018	2019E	% Change
Balance Sheet (KES.Bn)			
Loans & Advances	239.6	254.0	6.0
Government Securities	129.7	139.4	7.5
Total Assets	453.6	499.0	10.0
Customer Deposits	341.0	381.6	11.9
Income Statement (KES.Bn)			
Interest income (Loans & Advances)	23.9	24.9	4.0
Interest income (Gov't Securities)	14.2	14.4	1.7
Total Interest Income	40.4	41.2	2.0
Total Interest Expense	18.5	19.0	2.5
Net Interest Income	21.9	22.2	1.1
Non-Funded Income	16.1	19.3	20.0
Total Operating Income	36.4	41.5	14.0
Loan Loss Provisions	7.0	6.1	12.3
Total Operating Expenses	24.1	25.5	6.0
Profit After Tax	9.3	11.1	19.5
Ratios			
Cost to Income Ratio	47.0	46.8	0.2
NPL Ratio	12.3	12.0	0.3
Net Interest Margin	5.2	5.4	0.2
ROE	13.7	16.0	2.3

Source: Company Filings & Sterling Capital Research

4) Co-op Bank Ltd

Balance Sheet

- Total Assets FY2019 estimate at KES.452.2Bn, 9.4% growth over FY2018 supported by 9.7% and 11.4% increase in loan book and government securities to KES.269.3Bn and KES.94.1Bn respectively.
- We expect the bank to stick to its HY 2019 investment strategy of growing its holdings of Government securities at a faster pace than its loan assets.
- Faster H2 2019 loan book growth boosted by personal banking loans and e-credit lending.
- FY2019 customer deposit growth estimated at 5.8% to KES.324.5Bn driven by increased customer numbers and aggressive deposit mobilization.

Income Statement

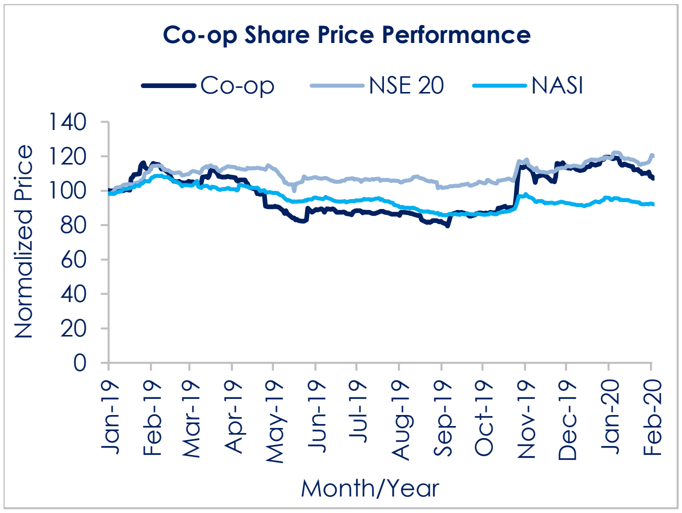
- FY2019 PAT expected to increase 12.4% over FY2018 to KES.14.3Bn with NFI up 38% to offset a 2.1% reduction in total interest income.
- Declining yields on loans and advances will see interest from loans and advances drop 6.1% to KES.30.9 while interest earnings from domestic debt securities will rise 11.2% to KES.10.9Bn on account of increased holdings.
- Operating expenses up 6.2% to KES.27.3Bn as a result of increased loan loss provisioning and staff costs.

Investment Recommendation

- Dividend per share to be maintained at KES.1.00.
- Our recommendation remains **BUY** on account of our **KES.17.25 fair value estimate** which represents a 16.2% upside from the current market price of KES.14.85.
- The bank trades on a **trailing P/E of 6.8x and a P/B of 1.3x** against sector average P/E of 7.1x and P/B of 1.2x.

Share Summary	
Fair Value Estimate (KES)	17.25
Recommendation	**BUY**
Current Price (KES)	14.85 (21-Feb-20)
Upside (%)	↑16.2
Price Change YOY (%)	↑0.7
Price Change YTD (%)	↓9.2
Dividend Yield (%)	6.7%
Trailing P/E	6.8x
Trailing P/B	1.3x
Issued Shares (Mn)	5,867.17
Free Float (%)	32.3
Market Cap (KES. Bn)	87.1
NSE Code	COOP
Bloomberg Code	COOP:KN

Source: Nairobi Securities Exchange & Sterling Capital Research



Source: Nairobi Securities Exchange & Sterling Capital Research

Key Financial Summary

	2018	2019E	% Change
Balance Sheet (KES.Bn)			
Loans & Advances	245.4	269.3	9.7
Government Securities	84.5	94.1	11.4
Total Assets	413.4	452.2	9.4
Customer Deposits	306.6	324.5	5.8
Income Statement (KES.Bn)			
Interest income (Loans & Advances)	32.9	30.9	6.1
Interest income (Gov't Securities)	9.8	10.9	11.2
Total Interest Income	43.0	42.1	2.1
Total Interest Expense	12.2	13.1	7.4
Net Interest Income	30.8	29.0	5.8
Non-Funded Income	12.9	17.8	38.0
Total Operating Income	43.7	46.8	7.1
Loan Loss Provisions	1.8	2.8	55.6
Total Operating Expenses	25.7	27.3	6.2
Profit After Tax	12.7	14.3	12.4
Ratios			
Cost to Income Ratio	54.6	52.2	2.4
NPL Ratio	11.2	10.7	0.5
Net Interest Margin	9.4	8.0	1.4
ROE	18.3	19.4	1.1

Source: Company Filings & Sterling Capital Research

5) Diamond Trust Bank Kenya Plc

Balance Sheet

- Total assets to remain relatively flat with a 0.5% (KES.284.5Bn) growth expected attributable to slow loan book and investment in Government securities growth.
- The bank reported a decline in both loans and Government securities investments and a slight improvement in H2 will see a 0.4% and 3% growth in loans and Government securities to KES.193.9Bn and KES.118.5Bn.
- Customer deposit mobilization has been a challenge especially in Q2 and Q3 and we expect this to result in a near flat 0.5% growth to KES.284.3Bn.

Income Statement

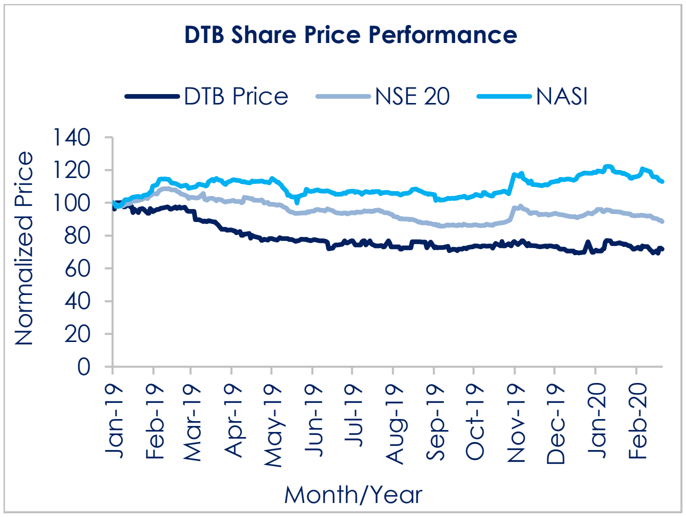
- PAT up 13% to KES.8Bn driven by 8% NFI growth to KES.5.8Bn with total interest income expected to decline 6.6% to KES.32.9Bn.
- Slow growth in interest earning assets will result in a 7.5% and 5.8% decline in interest income from loans and Government securities to KES.20.3Bn and KES.12.3Bn respectively.
- Strong NFI growth FY2019 will see an improved proportional contribution of NFI to total operating to 23.4% from 21.2% FY2018.
- Our operating expenses estimate FY2019 is KES.12.2Bn up 6.1%, mainly driven by a 5% increase in staff costs.

Investment Recommendation

- Dividend per share likely to remain unchanged at KES.2.60 per share on account of the bank's uninspiring FY2019 performance.
- We however give a **BUY** recommendation guided by our **fair value estimate of KES.142** with favorable **trailing P/E and P/B multiples of 4.7x and 0.6x** respectively well below industry averages of 6.9x and 1.2x.
- Our fair value estimate represents an upside of 26.7% based on the current share price of KES.112.00.

Share Summary	
Fair Value Estimate (KES)	142
Recommendation	**BUY**
Current Price (KES)	112.00 (21-Feb-20)
Upside (%)	↑26.7
Price Change YOY (%)	↓25.8
Price Change YTD (%)	↑ 0.9
Dividend Yield (%)	2.3
Trailing P/E	4.7
Trailing P/B	0.6
Issued Shares (Mn)	279.60
Free Float (%)	58.4
Market Cap (KES.Bn)	29.10
NSE Code	DTK
Bloomberg Code	DTKL : KN

Source: Nairobi Securities Exchange & Sterling Capital Research



Source: Nairobi Securities Exchange & Sterling Capital Research

Key Financial Summary

	2018	2019E	% Change
Balance Sheet (KES.Bn)			
Loans & Advances	193.1	193.9	0.4
Government Securities	115.0	118.5	3.0
Total Assets	377.7	383.7	1.6
Customer Deposits	282.9	284.3	0.5
Income Statement (KES.Bn)			
Interest income (Loans & Advances)	22.0	20.3	7.5
Interest income (Gov't Securities)	13.0	12.3	5.8
Total Interest Income	35.3	32.9	6.6
Total Interest Expense	15.2	14.0	8.1
Net Interest Income	20.0	18.9	5.5
Non-Funded Income	5.4	5.8	8.0
Total Operating Income	25.5	24.8	2.6
Loan Loss Provisions	3.0	1.2	60.0
Total Operating Expenses	11.5	12.2	6.1
Profit After Tax	7.1	8.0	13.1
Ratios			
Cost to Income Ratio	45.2	49.2	4.0
NPL Ratio	7.0	7.0	0.0
Net Interest Margin	6.2	5.8	0.4
ROE	13.1	13.1	0.0

Source: Bank Filings & Sterling Capital Research

6) ABSA Bank Kenya Plc

Balance Sheet

- Total assets to grow at 12.8% over FY2018 to KES.366.5Bn with 11.7% increase in loans and advances to KES.198.2Bn and 28% increase in holdings of Government securities to KES.119Bn.
- Aggressive deposit mobilization especially from the bank's retail customer base to result in a 16% growth in customer deposits to KES.240.6 Bn.

Income Statement

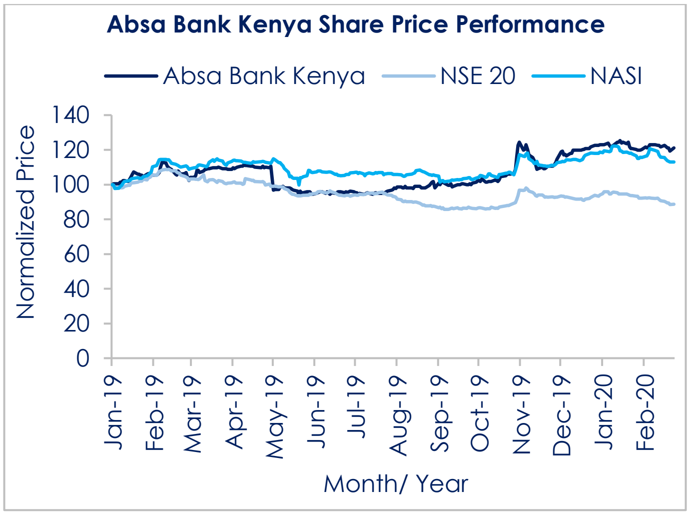
- We expect PAT to edge up 4.9% over FY2018 to KES.7.8Bn.
- Estimate 6.5% growth in total interest income to KES.30.9Bn, supported by 14.8% (KES.8.5Bn) growth in interest income from Government securities and 2.9% increase in income from loans and advances.
- The digital lending platform 'Timiza' is expected to be a key driver of interest income from the bank's retail clients.
- 7.5% growth in NFI to KES.10.4Bn, driven by fees and commissions and foreign exchange trading income.
- Operating expenses to increase by 7.3%, attributable to costs incurred in separation from the parent company. This is expected to result in an increased cost to income ratio of 55.3%.
- A slight deterioration in the bank's asset quality is expected due to loan book expansion with NPL ratio FY2019 estimated at 6.8% from 6.1% FY2018.

Investment Recommendation

- The bank is likely to issue a final dividend of KES.0.90 per share, resulting in a total dividend of KES.1.10 similar to FY2018.
- We maintain our **HOLD** recommendation guided by our **fair value estimate of KES.13.25** with **trailing P/E and P/B multiples of 9.5x and 1.6x** respectively against the industry averages of 7.1x and 1.2x.
- Our Fair value estimate represents an upside of 6.8% based on the current share price of KES.12.95.

Share Summary	
Fair Value Estimate (KES)	13.25
Recommendation	**HOLD**
Current Price (KES)	12.95 (21-Feb-20)
Upside (%)	↑2.3
Price Change YOY (%)	↑11.6
Price Change YTD (%)	↓ 3.0
Dividend Yield (%)	8.5
Trailing P/E	9.5
Trailing P/B	1.6
Issued Shares (Mn)	5,431.54
Free Float (%)	31.5
Market Cap (KES. Bn)	71.42
NSE Code	ABSA
Bloomberg Code	ABSA KN

Source: Nairobi Securities Exchange & Sterling Capital Research



Source: Nairobi Securities Exchange & Sterling Capital Research

Key Financial Summary

	2018	2019E	% Change
Balance Sheet (KES.Bn)			
Loans & Advances	177.4	198.1	11.7
Government Securities	92.9	119.0	28.0
Total Assets	324.8	366.5	12.8
Customer Deposits	207.4	239.6	15.5
Income Statement (KES.Bn)			
Interest income (Loans & Advances)	21.5	22.2	2.9
Interest income (Gov't Securities)	7.4	8.5	14.8
Total Interest Income	29.1	30.9	6.5
Total Interest Expense	7.1	8.0	13.7
Net Interest Income	22.0	22.9	6.6
Non-Funded Income	23.0	25.2	9.6
Total Operating Income	71.8	77.1	4.2
Loan Loss Provisions	3.9	3.8	1.9
Total Operating Expenses	17.2	18.4	7.3
Profit After Tax	7.4	7.8	4.9
Ratios			
Cost to Income Ratio	54.2	55.3	1.1
NPL Ratio	6.1	6.8	0.7
Net Interest Margin	8.6	7.7	0.9
ROE	16.8	16.9	0.1

Source: Company Filings & Sterling Capital Research

7) Stanbic Holdings Plc

Balance Sheet

- Strong 13% FY2019 asset book growth expected over FY2018 to KES.328.8Bn supported by 18% growth in loans and advances to KES.173Bn.
- Bank's investment in Government securities to grow at a modest 3% to KES.72.5Bn.
- We estimate a 16% growth in customer deposits to KES.222.2Bn.

Income Statement

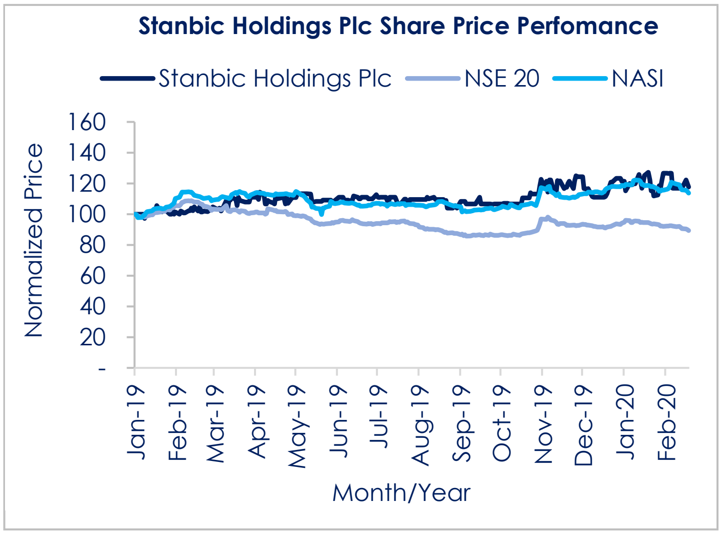
- PAT growth of 25.4% to KES.7.9Bn driven by an increase in both net interest income and NFI.
- Forecast 17.4% net interest income growth to KES.14.2Bn from robust growth in interest income on loans and advances.
- NFI to increase by 7% to KES.10.7Bn driven by increased fees and commissions.
- Comparatively slower growth (4.5%) in operating expenses to KES.11.6Bn will see the bank's Cost to Income Ratio (CTI) improve to 46.8% compared to 50.2% FY2018.

Investment Recommendation

- Final Dividend expected to remain unchanged over FY2018 at KES.3.55 for a total dividend of KES.4.80 compared to KES.5.80 FY2018.
- We maintain a **BUY** recommendation guided by our **fair value estimate of KES.121** with **trailing P/E and P/B multiples of 6.7x and 0.9x** respectively against the industry averages of 7.1x and 1.2x.
- Our fair value estimate gives an upside of 14% based on the current share price of KES.106.

Share Summary	
Fair Value Estimate (KES)	121
Recommendation	**BUY**
Current price (KES)	106 (21-Feb-20)
Upside (%)	↑14
Price Change YOY (%)	↑16.2
Price Change YTD (%)	↓3
Dividend yield (%)	5.5
Trailing P/E	6.7
Trailing P/B	0.9
Issued Shares (Mn)	395
Free Float (%)	31
Market Cap (KES.Bn)	41.9
NSE Code	CFC
Bloomberg Code	CFCB:KN

Source: Nairobi Securities Exchange & Sterling Capital Research



Source: Nairobi Securities Exchange & Sterling Capital Research

For important disclosures refer to the disclosures section located at the end of this report.

Key Financial Summary

	2018	2019E	% Change
Balance Sheet (KES.Bn)			
Loans & Advances	146.6	173.0	18.0
Government Securities	70.4	72.5	3.0
Total Assets	290.6	328.8	13.1
Customer Deposits	191.6	222.2	16.0
Income Statement (KES.Bn)			
Net Interest income	12.1	14.2	17.4
Non-Funded Income	10.0	10.7	7.0
Total Operating Income	22.1	24.9	12.7
Loan Loss Provisions	2.1	1.9	9.5
Total Operating Expenses	11.1	11.6	4.5
Profit After Tax	6.3	7.9	25.4
Ratios			
Cost to Income Ratio	50.2	46.8	3.4
Net Interest Margin	5.3	5.4	0.1
ROE	14.3	15.1	0.8

Source: Bank Filings & Sterling Capital Research

8) I & M Holdings

Balance Sheet

- Total assets growth up 16.2% to KES.335.2Bn boosted by 7.7% and 6.7% growth in loan book and investment in Government securities holdings to KES.179.6Bn and KES.55.7Bn respectively.
- We estimate 14% growth in customer deposits to KES.242.9Bn.

Income Statement

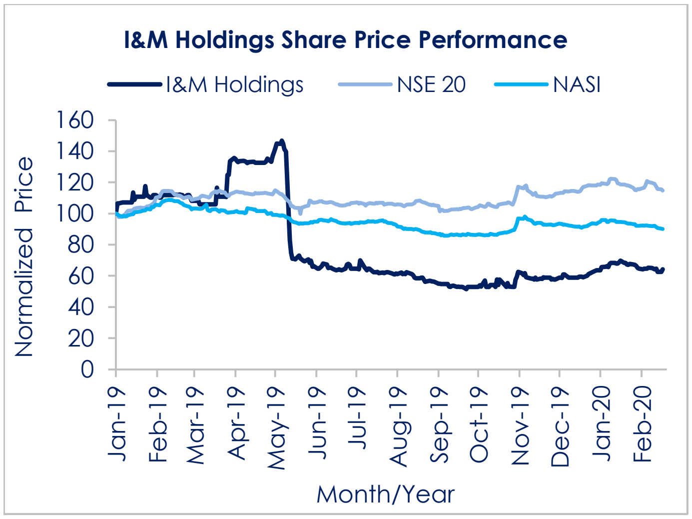
- PAT estimate of KES.9.3Bn equivalent to 9.4% growth over FY2018 mainly driven by 11.2% and 11.8% growth in interest income and NFI respectively.
- Total interest income up 11.2% (KES.28.9Bn) boosted by 12.4% (KES.23.6Bn) growth in interest income from loan and advances.
- Total interest income up 11.2% (KES.28.9Bn) boosted by 12.4% (KES.23.6Bn
- NFI growth to KES.8.5Bn attributable to 16.2% (KES.4.3Bn) increase in fees and commission income and 14.0% (KES.3.5Bn) rise in trading income.
- A 5.0% increase in operating expenses to KES.12.6Bn is anticipated FY2019 due to a 10% increase in both staff costs and credit impairment charges to KES.4.5Bn and KES.4.2Bn respectively.
- NPLs ratio expected to improve to 12% compared to 13.3% FY2018 but still remain amongst the highest in covered banks.

Investment Recommendation

- We expect a dividend of **KES.1.95** per share, a 50% decline from KES.3.90 FY2018 due to a 2:1 share split.
- We recommend a **BUY** on **I&M Holdings** based on a **fair value estimate of KES.61.70** a 13.2% upside from the current market price of KES.54.50.
- The bank trades on a **trailing P/E of 5.3x and a P/B of 0.9x** against sector average P/E of 6.9x and P/B of 1.2x.

Share Summary	
Fair Value Estimate (KES)	**61.70**
Recommendation	**BUY**
Current Price (KES)	54.50 (21-Feb-20)
Upside (%)	↑13.2
Price Change YOY (%)	↓ 42.6
Price Change YTD (%)	↑0.9
Dividend Yield (%)	3.6
Trailing P/E	5.3
Trailing P/B	0.9
Issued Shares (Mn)	826.8
Free Float (%)	25.7
Market Cap (KES. Bn)	45.1
NSE Code	I&M
Bloomberg Code	IMH:KN

Source: Nairobi Securities Exchange & Sterling Capital Research



Source: Nairobi Securities Exchange & Sterling Capital Research

Key Financial Summary

	2018	2019E	% Change
Balance Sheet (KES.Bn)			
Loans & Advances	166.7	179.6	7.7
Government Securities	52.2	55.7	6.7
Total Assets	288.5	335.2	16.2
Customer Deposits	213.1	242.9	14.0
Income Statement (KES.Bn)			
Interest income (Loans & Advances)	21.0	23.6	12.4
Interest income (Gov't Securities)	5.0	5.2	4.0
Total Interest Income	26.0	28.9	11.2
Total Interest Expense	10.4	12.0	14.9
Net Interest Income	15.6	16.9	8.3
Non-Funded Income	7.6	8.5	11.8
Total Operating Income	22.9	25.2	10.0
Loan Loss Provisions	3.8	4.2	10.0
Total Operating Expenses	12.0	12.6	5.0
Profit After Tax	8.5	9.3	9.4
Ratios			
Cost to Income Ratio	37.0	36.5	0.5
NPL Ratio	13.3	12.0	1.3
Net Interest Margin	7.9	7.3	0.6
ROE	17.2	17.8	0.6

Source: Nairobi Securities Exchange & Sterling Capital Research

9) Standard Chartered Bank Kenya Ltd

Balance Sheet

- A marginal 1.1% increase in total assets to KES.288.4Bn expected as a result of 1.6% (KES.119Bn) and 0.3% (KES.97.1Bn) growth in holdings of Government securities and loans and advances respectively.
- Customer deposits have been declining on a quarterly basis since this year but we expect improvement in the last quarter bringing total customer deposits FY2019 to KES.225.4Bn a 0.5% over FY2018.

Income Statement

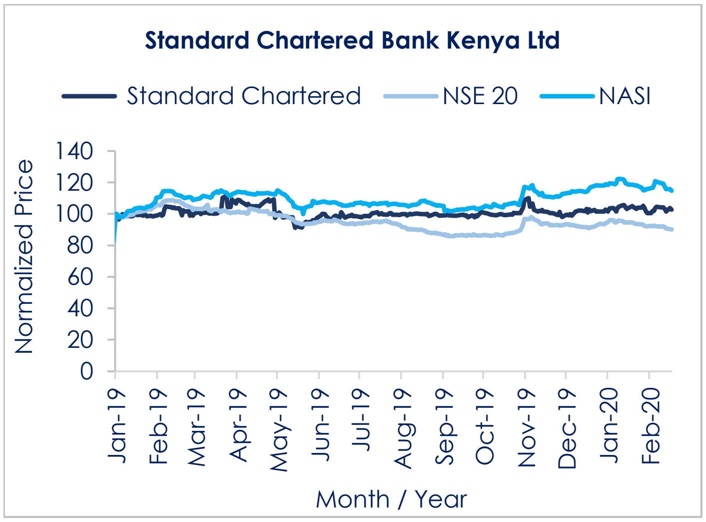
- PAT up 4.9% over FY2018 to KES.8.5Bn with the modest growth attributable to 4.7% growth in interest from loans and advances to KES.13.3Bn.
- A combination of slow loan book growth and investment holdings in Government securities as well as declining yields on both interest earning assets expected to result in a 3.3% decline in total interest income to KES.26.0Bn.
- Estimate 11.2% decline in Interest income from Government securities to KES.11.1Bn.
- NFI projected to decline by 2.3% due to a decrease in fees and commission income.
- Operating expenses up 2.1% to KES.14.9Bn driven by higher staff costs.
- FY2019 NPL ratio to deteriorate to 17.6% from 16.3% FY2018.

Investment Recommendation

- Final dividend to remain at KES.14 bringing the total dividend FY2019 at KES.19.
- A **HOLD** recommendation is maintained guided by our **fair value estimate of KES.205.75** with **trailing P/E and P/B multiples of 8.7x and 1.5x** respectively against the industry averages of 7.1x and 1.2x.
- Our fair value estimate is an upside of 2% on the current share price of KES.201.75.

Share Summary	
Fair Value Estimate (KES)	205.75
Recommendation	**HOLD**
Current Price (KES)	201.75 (21-Feb-20)
Upside (%)	↑2
Price Change YOY (%)	0
Price Change YTD (%)	↑0.9
Dividend Yield (%)	9.4
Trailing P/E	8.7
Trailing P/B	1.5
Issued Shares (Mn)	343.5
Free Float (%)	24.3
Market Cap (KES.Bn)	69.3
NSE Code	SCBK
Bloomberg Code	SCBK:KN

Source: Nairobi Securities Exchange & Sterling Capital Research



Source: Nairobi Securities Exchange & Sterling Capital Research

Key Financial Summary

	2018	2019E	% Change
Balance Sheet (KES.Bn)			
Loans & Advances	118.7	119.0	0.3
Government Securities	98.7	97.1	1.6
Total Assets	285.4	288.4	1.1
Customer Deposits	224.3	225.4	0.5
Income Statement (KES.Bn)			
Interest income (Loans & Advances)	12.7	13.3	4.7
Interest income (Gov't Securities)	12.5	11.1	11.2
Total Interest Income	26.9	26.0	3.3
Total Interest Expense	7.8	6.2	20.5
Net Interest Income	19.1	19.8	3.7
Non-Funded Income	8.7	8.5	2.3
Total Operating Income	27.8	28.3	1.8
Loan Loss Provisions	1.3	0.9	30.8
Total Operating Expenses	14.6	14.9	2.1
Profit After Tax	8.1	8.5	4.9
Ratios			
Cost to Income Ratio	52.5	52.6	0.1
NPL Ratio	16.3	17.6	1.1
Net Interest Margin	14.3	15.3	1.0
ROE	17.4	16.8	0.6

Source: Bank Filings & Sterling Capital Research

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BUY: FV above13% of CSP

Hold: FV between 0% and 12.99% around CSP

Sell: FV less than 0% below CSP

NB: The recommendation guide may change depending on the risk free rate.