Equity Group Holdings Earnings Update – Q1'2016
10th May 2016

Valuation Summary

- We recommend a HOLD for the Equity Group Holdings stock with a target price of Kshs 41.90 representing an upside of 9.1%, from the current price of Kshs 40.30, as at Friday, 13th May 2016, inclusive of a dividend yield of 5.0%
- Equity Group Holdings is currently trading at a P/B of 2.2x and a P/E of 8.2x, versus an industry average of 1.6x and 7.5x, respectively

Key highlights during the quarter

- The Equitel Platform continued to outperform market expectations;
  i. loan limit on the platform has been increased to Kshs 1.0 mn and loan period to 1 year,
  ii. number of customers has grown 179.4% to 1.9 mn from 0.7 mn in Q1'2015, and
  iii. transaction numbers via the platform have grown 314.5% to 45.6 mn from 11.0 mn
- Equity Group Holdings has opened 7 new branches in Tanzania

Income Statement

- Core earnings per share grew by 19.8% to Kshs 1.39 per share in Q1'2016 from Kshs 1.16 per share in Q1'2015, driven by an 18.2% growth in operating revenue in Q1'2016 which outpaced a 17.2% growth in operating expenses in Q1'2016
- Operating revenue grew by 18.2% to Kshs 15.6 bn in Q1'2016 from Kshs 13.2 bn in Q1'2015 driven by a 36.0% growth in interest income compared to our 15.2% projection, which was supported by the relatively high interest environment, with spill overs from 2015. Interest income recorded a growth of 36.0% to Kshs 12.9 bn from Kshs 9.5 bn in Q1'2015 due to a strong growth in loan disbursement driven by the Equitel platform that has seen a growth of 314.5% in transaction numbers to 45.6 mn from 11.0 mn in Q1'2015 and a 563.8% growth in transaction volumes to Kshs 62.4 bn from Kshs 9.4 bn in Q1'2015. Interest expenses grew by 32.2% to Kshs 2.4 bn in Q1'2016 from Kshs 1.9 bn in Q1'2015. Net interest income rose by 37.0% to Kshs 10.4 bn in Q1'2016 from Kshs 7.6 bn in Q1'2015, against our projections of an 11.1% growth
- Non-funded income recorded a decline of 7.2% to Kshs 5.2 bn from Kshs 5.6 bn in Q1'2015, lower than our projection of a 20.7% increase. This was brought on by the drop in forex income by 4.8% partly due to South Sudan as a result of impairment of business following the devaluation of the currency despite the increase in mobile, merchant and agency banking transaction volumes. The current revenue mix stands at 67:23 funded to non-funded income with Equity Group hoping to grow the non-funded stream through fees and commissions supported by Equitel
- Operating expenses grew by 17.2% to Kshs 8.4 bn in Q1'2016 from Kshs 7.1 bn in Q1'2015 driven by a 21.5% rise in staff costs and a 103.7% increase in loan loss provision charge. Other operating expenses increased by 5.0% as a result of expansion process in DRC as the Group hopes to break even from its Pro Credit investment in the second quarter of the year and 7 new branches in Tanzania. The faster growth in revenues resulted in a marginal decline in cost to income ratio of 53.4% from 53.9% in Q1'2015
- Q1'2016 PAT growth came in higher than our expectations (19.6% growth to Kshs 5.1 bn from Kshs 4.3 bn compared to our projection of a 12.7% growth). The disparity was driven by growth of loan uptake through the Equitel Platform that grew the number of customers of Equity Group Holdings to 10.3 mn from 9.6 mn in Q1'2015

Balance Sheet

- The balance sheet recorded a relatively good growth with total liabilities increasing by 15.9% to Kshs 361.0 bn from Kshs 311.6 bn in Q1'2015 compared to our projections of a 24.2% growth while shareholders' funds increased by 13.5% to Kshs 69.1 bn
- Customer deposits increased by 8.1% to Kshs 299.2 bn from Kshs 276.8 bn in Q1'2015 compared to our growth projection of 20.1%. Equity cited cutting back on fixed deposits as they were able to secure much cheaper

funds (a total of Kshs 20.0 bn at 4.0% per annum compared to an average fixed deposit rate of 7.5%) from international investors during the Global Entrepreneurship Summit last year, with borrowings increasing by 52.3% to Kshs 39.9 bn in Q1'2015. Loan growth outpaced deposit growth coming at 22.4% to Kshs 275.0 bn from Kshs 224.8 bn in Q1'2015 driven largely by the ease of uptake of loans through their Equitel platform which is currently disbursing 80.0% of total Equity Bank Kenya loans. This increased the loan to deposit ratio to 91.9% from 81.2% in Q1'2015, slightly higher than the industry average of 89.0%

- Non-performing loans grew by 35.8% to Kshs 10.9 bn from Kshs 8.0 bn in Q1'2015 compared to an increase in gross loans of 22.2% which led to an increase in NPL ratio to 3.9% from 3.5%. The increase in non-performing loans was attributed to the interest spike that Equity Group implemented following the high interest rates in September and October last year whose effect on distressed SME clients was felt in Q1'2016. Equity hopes to reduce the NPL ratio to 2.0% through Equitel that has shown an average loan repayment rate of 97.0%
- The yield on interest earning assets increased to 13.9% from 13.1% in Q1'2016 higher than the cost of funds that increased to 3.1% from 2.5% leading to a slight increase in the net interest margin to 11.0% from 10.7%
- Equity Group Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 18.3%, 7.8% above the statutory requirement

Equity management remains positive that;

i. the uptake of alternative channels through Equitel and agency banking as they capture the market of customers who want to borrow but have low capability due to credit status,
ii. the new investment opportunity that has availed itself through Pro Credit in Democratic Republic of Congo, and,
iii. increased regulation by the Central Bank of Kenya and internal controls on corporate governance;

will push forward the growth agenda of the Group going into the rest of the year

Below is a summary of the key line items in the balance sheet and income statement

Figures in Kshs billions unless otherwise stated

Balance Sheet	Q1'2015	Q1'2016	y/y change	Q1'2016e	% y/y change	Variance in Growth Actual vs. Expected
Government Securities	48.9	62.4	27.5%	45.3	(7.4%)	35.0%
Net Loans and Advances	224.8	275.0	22.4%	283.0	25.9%	(3.5%)
Total Assets	372.5	430.2	15.5%	462.1	12.6%	2.9%
Customer Deposits	276.8	299.2	8.1%	332.4	20.1%	(12.0%)
Borrowings	26.2	39.9	52.3%	34.3	31.1%	21.2%
Total Liabilities	311.6	361.1	15.9%	387.1	24.2%	(8.4%)
Shareholders' Funds	60.9	69.1	13.5%	75.0	23.2%	9.7%

Balance Sheet Ratios	Q1'2015	Q1'2016	y/y change
Loan to Deposit Ratio	81.2%	91.9%	10.7%
Return on average equity	31.7%	27.9%	(3.7%)
Return on average assets	5.3%	4.5%	(0.7%)

Income Statement	Q1'2015	Q1'2016	y/y change	Q1'2016e	% y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	7.6	10.4	37.0%	8.5	11.1%	25.9%
Net non-Interest Income	5.6	5.2	(7.2%)	6.8	20.7%	(27.9%)
Total Operating income	**13.2**	**15.6**	**18.2%**	**15.2**	**15.2%**	**3.0%**
Loan Loss provision	(0.3)	(0.7)	103.7%	(0.5)	46.7%	57.0%
Total Operating expenses	(7.1)	(8.4)	17.2%	(8.3)	16.9%	0.4%
Profit before tax	**6.1**	**7.3**	**19.3%**	**6.9**	**13.2%**	**6.1%**
Profit after tax	**4.3**	**5.1**	**19.6%**	**4.8**	**12.7%**	**6.9%**

Income Statement Ratios	Q1'2015	Q1'2016	y/y change
Yield from interest-earning assets	13.1%	13.9%	0.4%
Cost of funding	2.5%	3.1%	0.0%
Net Interest Margin	11.0%	10.7%	0.3%
Cost to Income	53.9%	53.4%	(3.8%)
Cost to Assets	1.9%	1.9%	(5.6%)
Net Interest Income as % of operating income	57.5%	66.7%	5.8%
Non-Funded Income as a % of operating income	42.5%	33.3%	(5.8%)

Capital Adequacy Ratios	Q1'15	Q1'16
Core Capital/Total Liabilities	18.8%	24.2%
Minimum Statutory ratio	10.5%	10.5%
Excess	**8.3%**	**13.7%**
Core Capital/Total Risk Weighted Assets	16.2%	18.3%
Minimum Statutory ratio	10.5%	10.5%
Excess	**5.7%**	**7.8%**
Total Capital/Total Risk Weighted Assets	18.2%	19.6%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.7%**	**5.1%**
Liquidity Ratio	39.3%	34.9%
Minimum Statutory ratio	20.0%	20.0%
Excess	**19.3%**	**14.9%**