

Valuation Summary

- We recommend an ACCUMULATE for the Equity Group Holdings stock with a target price of Kshs 34.2 representing an upside of 19.0%, from the current price of Kshs 30.5, as at 3rd November, 2016, inclusive of a dividend yield of 6.8%
- Equity Group is currently trading at a P/B of 1.4x, versus an industry average of 0.9x: and a P/E of 5.9x, versus an industry average of 5.2x

Key highlights during the Quarter

- The Equitel Platform continues to outperform market expectations;
 - Number of customers have grown by 105.9% in Q3'2016 to 2.4 mn from 1.2 mn in Q3'2015,
 - Cumulative transaction numbers on the platform and value have increased by 198.1% and 430.4% to 313 mn and 366 bn, respectively, since Q3'2015
 - In terms of market share for transaction value and numbers as at Q2'2016, Equitel has now captured 14.5% and 15.2% from 7.4% and 13.0% in Q1'2016, respectively, and,
 - The Equitel platform has an average of 97.0% loan recovery rate indicating the high-quality of the loans being disbursed through the platform.
- 84.9% of Equity bank's total transactions are now being processed through 3rd party infrastructure (Mobile and Agency), highlighting the achievement Equity Bank has made in alternative channels of banking

Income Statement

- Core earnings per share (EPS) increased by 17.7% to Kshs 4.0 per share in Q3'2016 from Kshs 3.4 per share in Q3'2015 driven by a faster growth in operating revenue of 15.3%, which outpaced operating expense growth of 13.3% in Q3'2016. This was in line with our expectation of a 17.4% EPS growth
- Operating revenue grew by 15.3% to Kshs 48.9 bn in Q3'2016 from Kshs 42.4 bn in Q3'2015 driven by a 26.3% growth in net interest income and a 1.4% decline in Non-Funded Income to Kshs 16.6 bn from Kshs 16.8 bn in Q3'2015
- Net Income interest income growth was supported by 26.0% growth in Interest Income to Kshs 39.8 bn from Kshs 31.6 bn which outpaced the 24.6% growth in interest expenses to Kshs 7.5 bn from Kshs 6.0 bn in Q3'2015
- Net interest margin increased to 11.0% from 10.2%
- Non-funded income recorded a decline of 1.4% to Kshs 16.6 bn from Kshs 16.8 bn in Q3'2015 driven by a 27.5% decline in fees and commissions on loans to Kshs 2.9 bn from Kshs 4.1 bn. The current revenue mix stands at 66:34 funded to non-funded income
- Operating expenses grew by 15.3% to Kshs 27.4 bn in Q3'2016 from Kshs 24.2 bn in Q3'2015 driven by a 95.3% increase in loan loss provision (LLP) to Kshs 3.3 bn from Kshs 1.7 bn in Q3'2015. Without LLP, operating expenses grew by 7.1% to Kshs 24.1 bn from Kshs 22.5 bn in Q3'2015
- The slower growth in expenses resulted in a decline in cost to income ratio to 56.0% from 57.0% in Q3'2015
- PAT grew by 17.7% to Kshs 15.1 bn from Kshs 12.8 bn in Q3'2015 compared to our expectations of a 17.4% rise

Balance Sheet

- The balance sheet recorded growth with total assets rising by 5.0% to Kshs 468.0 bn from Kshs 445.8 bn in Q3'2015 driven by an 80.8% increase in government securities to Kshs 93.1 bn from Kshs 51.5 bn.
- Loan book grew slightly by 3.0% to Kshs 271.4 bn from Kshs 263.4 bn, while investment in Treasury instruments increased by 80.8% to Kshs 93.1 bn from Kshs 51.5 bn in Q3'2015, an indication that banks are preferring to lend more to the government due to the interest rates cap
- Customer deposits grew by 4.8% to Kshs 331.3 bn from Kshs 316.1 bn in Q3'2015, driven by an increase in interest bearing deposits by 25.5% to Kshs 103.4 bn from Kshs 82.4 bn. Non-interest bearing deposits shrank by 2.8% to Kshs 227.9 bn from Kshs 234.5 bn bringing the deposit mix to 69:31 non-interest bearing to interest bearing
- Gross non-performing loans grew by 40.0% to Kshs 16.5 bn from Kshs 11.8 bn in Q3'2015 which led to an increase in NPL ratio to 5.9% from 4.4% in Q3'2015
- The yield on interest earning assets increased to 13.5% from 12.5% in Q3'2015 with the cost of funds rising to 3.0% from 2.4%
- Equity Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 22.5%, 14.5% above the statutory requirement with total capital to total risk weighted assets and well above the statutory requirement of 14.5% by 4.5%

Equity's growth will continue to be propelled by

- Innovation and execution through their alternative channels like agency and digital which have witnessed significant

growth and currently attributed to 84.9% of total transactions, and

- Further exploration of their regional business which is not under the Interest Rate Cap. 20% of Equity bank's assets are in their regional business and given that the macroeconomic conditions of these regional countries are displaying some level of synergy, exploiting this will drive growth going forward

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 Items	Q3'2015	FY'2015	Q3'2016	y/y change	Q3'2016e	% y/y change	Variance in Growth Actual vs. Expected
Government Securities	51.5	42.8	93.1	80.8%	56.6	9.9%	(70.9%)
Net Loans and Advances	263.4	269.9	271.4	3.0%	301.8	14.6%	11.5%
Total Assets	445.8	428.1	468.0	5.0%	459.6	3.1%	(1.9%)
Customer Deposits	316.1	302.2	331.3	4.8%	335.2	6.0%	1.2%
Total Liabilities	374.6	355.9	386.4	3.2%	385.3	2.8%	(0.3%)
Shareholders' Funds	71.1	72.1	81.6	14.7%	74.3	4.5%	(10.2%)

Balance Sheet Ratios	Q3'2015	Q3'2016	y/y change
Loan to Deposit Ratio	83.3%	81.9%	(1.4%)
Return on average equity	29.2%	25.7%	(3.6%)
Return on average assets	4.8%	4.3%	(0.5%)

Income Statement	Q3'2015	FY'2015	Q3'2016	y/y change	Q3'2016e	% y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	25.6	34.1	32.3	26.4%	29.1	13.6%	(12.7%)
Net non-Interest Income	16.8	21.9	16.6	(1.4%)	20.0	18.8%	20.2%
Total Operating income	42.4	56.1	48.9	15.3%	49.0	15.6%	0.3%
Loan Loss provision	(1.7)	(2.4)	(3.3)	95.3%	(2.3)	33.3%	(62.1%)
Total Operating expenses	(24.2)	(32.1)	(27.4)	13.3%	(27.6)	14.0%	0.7%
Profit before tax	18.1	24.0	21.5	18.6%	21.5	18.4%	(0.2%)
Profit after tax	12.8	17.3	15.1	17.7%	15.0	17.4%	(0.3%)

Income Statement Ratios	Q3'2015	Q3'2016	y/y change
Yield from interest-earning assets	12.5%	13.9%	1.3%
Cost of funding	2.4%	3.0%	0.6%
Net Interest Spread	10.2%	11.0%	0.8%
Net Interest Income as % of operating income	60.4%	66.1%	5.8%
Non-Funded Income as a % of operating income	39.6%	33.9%	(5.8%)
Cost to Income	57.0%	56.0%	(1.0%)
Cost to Assets	5.4%	5.9%	0.4%

Capital Adequacy Ratios	Q3'2015	Q3'2016
Core Capital/Total Liabilities	20.8%	22.5%
Minimum Statutory ratio	8.0%	8.0%
Excess	12.8%	14.5%
Core Capital/Total Risk Weighted Assets	18.4%	18.0%
Minimum Statutory ratio	10.5%	10.5%
Excess	7.9%	7.5%
Total Capital/Total Risk Weighted Assets	20.0%	19.0%
Minimum Statutory ratio	14.5%	14.5%
Excess	5.5%	4.5%

Liquidity Ratio	38.2%	42.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	18.2%	22.7%

