Equity Group Holdings – FY'2017
22nd March, 2018

Valuation summary

- We are of the view that Equity Group Limited stock is a "Sell", with a target price of Kshs 42.3 representing a downside of (13.1%), from the current price of Kshs 52.5, as at 22th March, inclusive of a dividend yield of 3.8%,
- Equity Group Holdings is currently trading at a P/TBV of 1.8x and a P/E of 10.5x vs an industry average P/TBV and P/E of 1.7x and 9.6x, respectively,

Key highlights during FY'2017

- Equity Group's subsidiaries registered strong growth during the year, with the subsidiaries' PBT growing by 81% in Uganda, 63% in DRC, 80% in Rwanda, 17% in Tanzania, 121% in South Sudan and 7% in Kenya
- The Global Credit Rating maintained Equity's investment grade AA- on long term and A1+ short-term with a stable outlook. Superbrand has recognized Equity Bank as the Top Banking Superbrand in Kenya for the last ten years
- The bank was named Best Retail Bank in Africa, Best Digital Bank in Kenya Best CSR East Africa in the 2017 African Banker Awards with its CEO, Dr James Mwangi being named Banker of the Year in East Africa

Income Statement

- Core earnings per share increased by 14.0% in FY'2017 to 5.0 from 4.4 FY'2016, higher than our expectations of 4.2. Performance was mainly driven by a 1.8% increase in operating income to Kshs 65.2 bn from Kshs 64.0 bn FY'2016, coupled with a decline in operating expenses by 2.1% to Kshs 38.3 bn from Kshs 39.1 bn FY'2016,
- Total operating revenue grew by 1.8% to Kshs 65.2 bn up from Kshs 64.0 bn in FY'2016, driven by a 24.2% increase in Non-Funded Income to Kshs 27.6 bn up from Kshs 22.2 bn in FY'2016, which offset a 10% decline in Net Interest Income to Kshs 37.6 bn from Kshs 41.8 bn in FY'2016,
- Interest Income declined by 6.6% y/y to Kshs 48.4 bn from Kshs 51.8 bn in FY'2016, largely due to a 21.3% decline in interest income on loans and advances to Kshs 33.9 bn from Kshs 43.1 bn. However, interest income on government securities grew by 27.3% to Kshs 128.0 bn from Kshs 100.6 bn in FY'2016. As a result of the decline in interest income, the yield on interest-earning assets declined to 11.6% from 13.8% in FY'2016,
- Interest expense increased by 8.1% to Kshs 10.8 bn from Kshs 10.0 bn in FY'2016, following a 10.7% increase in customer deposits to Kshs 373.1 bn from Kshs 337.2 bn in FY'2016. Cost of funds came in at 2.7%, unchanged from FY'2016. Net Interest Margin declined to 9.0% from 11.1% in 2016,
- Non-Funded Income recorded a growth of 24.2% to Kshs 27.6 bn from Kshs 22.2 bn in FY'2016, driven by a 24.3% increase in Forex Income to Kshs 4.1 bn from Kshs 3.3 bn. Other fees and commissions increased by 33.9% to Kshs 5.9 bn from Kshs 4.4 bn. This growth can be credited to an increase in transactions over digital platform. The Equitel app contributed the most transactions via the online platform accounting for 94% of all transactions done in FY'2017. The revenue mix currently stands at 58:42 Funded to Non-Funded Income from the 65:35 recorded in FY'2016, owing to an increase in NFI coupled with a decline in NII,
- Total Operating expenses decreased by 2.1% to Kshs 38.3 bn from Kshs 39.1 bn in FY'2016. This was driven by a decline in the loan loss provision by 48.4% to Kshs 3.4 bn from Kshs 6.7 bn in FY'2016. The lower provisioning was justified by the Group's risk averse attitude to risky loans during the year with the Group's NPL ratio standing at 6.2%. Staff Costs expenses declined slightly by 1.3% to Kshs 11.5 bn from Kshs 11.6 bn FY'2016,

- The Cost to Income ratio improved to 58.7% from 61.1% in FY'2016, mainly credited to the 48.4% decline in loan loss provision (LLP). Without LLP, the cost to Income ratio deteriorated to 53.5% from 50.7% in FY'2016,
- Profit before tax experienced a growth of 7.9% to Kshs 26.9 bn from Kshs 24.9 bn, while profit after tax grew by 14.0% to Kshs 18.9 bn from Kshs 16.6 bn in FY'2016. The effective tax rate declined to 28.7% from 34.4% in FY'2016,
- The bank recommended a dividend of Kshs 2.0 per share similar to that of FY'2016, translating to a dividend yield of 3.8%

Balance sheet

- Total assets grew by 10.7% to Kshs 524.5 bn from Kshs 473.7 bn in FY'2016, mainly driven by the 27.3% increase in government securities to Kshs 128.0 bn from Kshs 100.6 bn in FY'2016. Net loans grew by 4.9% to Kshs 279.1 bn from Kshs 266.1 bn in FY'2016,
- Total liabilities rose by 10.1% to Kshs 431.3 bn from Kshs 391.7 bn, driven by a 10.7% increase in customer deposits to Kshs 373.1 bn from Kshs 337.2 bn in FY'2016. Borrowed funds grew by 0.8% to Kshs 46.1 bn from Kshs 45.6 bn in FY'2016, while deposits per branch grew by 4% to Kshs 1.3 bn from 1.27 bn FY'2016,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio (LDR) to 74.8% from 78.9% in FY'2016,
- Gross non-performing loans decreased by 18.1% to stand at Kshs 18.0 bn down from Kshs 18.8 bn in FY'2016, improving the Non-Performing Loans ratio to 6.2% from 6.8% in FY'2016,
- Shareholders' funds increased by 13.6% to Kshs 93.1 bn from Kshs 82.0 bn in FY'2016. This is largely due to a 25.6% growth in retained earnings to Kshs 11.4 bn from Kshs 9.1 bn in FY'2016,
- Equity Group Holdings is sufficiently capitalized with a core capital to risk weighted assets ratio at 19.8%, with an excess of 9.2% above the statutory requirement of 10.5%. Total capital to risk weighted assets increased to 20.5% from 19.7% in FY'2016,
- The return on average assets is currently at 3.8%, and an average return on equity at 21.6%

Key Take out

Despite the challenging macro-economic environment characterized by political uncertainties and elevated inflation, the group was able to sustain and improve on its profitability largely due to its regional penetration, channel diversification and structural efficiency. It reported a revenue growth of 1.8% to Kshs 65.2 bn from Kshs 64.0 bn despite the interest capping. This was as a result of the non-funded income emerging as a key differentiator with a positive growth of 24.2% to Kshs 27.6 bn from Kshs 22.2 bn. Regional diversification boosted the groups revenue enhancing the PAT contribution of the subsidiaries from 7% to 14%. Adoption of alternative distribution channels such as Equitel and Eazzy Bizz also enabled the group to expand its reach to customers with 96% of the Group's transactions done outside the branches.

Going forward, we expect Equity Group's growth to be propelled by;

(i) Channel diversification, with the Equitel mobile platform proving a key revenue driver for the bank, allowing a more efficient and customer convenient channel that allows for more transactional fee-based income, thus increasing its Non-Funded Income.

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

Figures in Kshs billions Unless otherwise stated

Cytonn INVESTMENTS

Equity Group Holdings – FY'2017

22nd March, 2018

Balance sheet Items	2016	2017	y/y change	FY'2017e	Expected y/y change	Variance in Actual Growth vs Expected
Government Securities	100.6	128.0	27.3%	111.9	11.2%	16.1%
Net Loans and Advances	266.1	279.1	4.9%	270.3	1.6%	3.3%
Total Assets	**473.7**	**549.4**	**16.0%**	**528.3**	**11.5%**	**4.5%**
Customer Deposits	337.2	373.1	10.7%	375.4	11.3%	(0.6%)
Total Liabilities	391.7	431.3	10.1%	443.6	13.2%	(3.2%)
Shareholders Fund's	**82.0**	**93.1**	**13.6%**	**84.7**	**3.3%**	**10.4%**

Balance sheet Ratios	2016	2017	% y/y change
Loan to Deposit Ratio	78.9%	74.8%	5.2%
Return on Average Equity	21.5%	21.6%	(0.3%)
Return on Average Assets	3.7%	3.7%	0.4%

Income Statement	2016	2017	y/y change	FY'2017e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	41.8	37.6	(10%)	37.4	(11%)	1%
Net non-interest Income	22.2	27.6	24%	27.6	24%	0%
Total Operating income	64.0	65.2	2%	64.5	1%	1%
Loan Loss Provision	(6.6)	(3.4)	(48%)	(6.4)	(3%)	(45%)
Total Operating Expenses	(39.1)	(38.3)	(2%)	(41.9)	7%	(9%)
Profits Before Tax	24.9	26.9	8%	22.6	-9%	17%
Profits After Tax	**16.6**	**18.9**	**14%**	**15.8**	**(5%)**	**19%**
Core EPS	**4.4**	**5.0**	**14%**	**4.2**	**(5%)**	**19%**

Income Statement Ratios	2016	2017
Yield from Interest Earning assets	13.8%	11.6%
Cost of Funding	2.75%	2.7%
Net Interest Spread	11.1%	8.9%
Net Interest Margin	11.1%	9.0%
Cost of Risk	10.4%	5.3%
Net Interest Income as % of operating income	65.3%	57.7%
Non-Funded Income as % of operating income	34.7%	42.3%
Cost to Income Ratio	61.1%	58.7%

Capital Adequacy Ratios	2016	2016
Core Capital/Total Liabilities	23.3%	23.5%
Minimum Statutory ratio	10.5%	10.5%

Excess	12.8%	13.0%
Core Capital/Total Risk Weighted Assets	18.7%	19.8%
Minimum Statutory ratio	10.5%	10.5%
Excess	8.2%	9.2%
Total Capital/ Total Risk Weighted Assets	19.7%	20.5%
Minimum Statutory ratio	14.5%	14.5%
Excess	5.2%	5.9%
Liquidity Ratio	47.6%	54.2%
Minimum Statutory ratio	20.0%	20.0%
Excess	27.6%	34.2%