Equity Group Holdings Plc – H1’2017
25th August, 2017

Valuation Summary

- We are of the view that Equity Group Holdings Plc stock is an “sell”, with a target price of Kshs 38.4 representing an upside of 7.1%, from the current price of Kshs 43.5, as at 25th August, inclusive of a dividend yield of 4.6%,
- Equity Group is currently trading at a P/TBv of 2.2X and a P/E of 9.9x, vs an industry average of 1.6x and 7.9x, respectively.

Key highlights during H1’2017

- Moody's Investors Service (Moody's) assigned first-time B1 global local-currency deposit ratings and Counterparty Risk (CR) Assessments of Ba3 (cr) to Equity Bank Kenya Limited. On the Kenyan national scale, Moody's assigned deposit ratings of Aa1.ke/KE-1 to Equity Bank with a stable outlook,
- Following the political instability in South Sudan, Equity Group Holdings Plc was forced to close 8 of its 13 branches in South Sudan and lay off 200 of its 300 employees in the country. The Group also closed 11 of its 520 ATM lobbies in a bid to cut cost by shifting customers to alternative channels such as agency and mobile banking.

Income Statement

- Core earnings per share declined by 7.8% to Kshs 2.47 from Kshs 2.68 in H1’2016, driven by a 3.6% decline in total operating revenue, that outpaced a decline of 1.3% in operating expenses in H1’2017,
- Total operating revenue declined by 3.6% to Kshs 30.9 bn from Kshs 32.1 bn in H1’2016. This was due to a 15.6% decline in Net Interest Income (NII), despite a 19.6% growth in Non-Funded Income (NFI),
- Interest Income declined by 11.8% to Kshs 23.0 bn from Kshs 26.1 bn in H1’2016, and interest expense increased by 4.1% to Kshs 5.1 bn from Kshs 4.8 bn in H1’2017, leading to a reduction in the Net Interest Margin to 9.7% from 10.8% in H1’2016
- Non-Funded Income (NFI) recorded a growth of 19.6% to Kshs 13.0 bn from Kshs 10.8 bn in H1’2016. The growth in NFI was driven by an increase in total fees and commissions that rose by 41.9% to Kshs 2.9 bn from Kshs 2.0 bn in H1’2016. Commission from alternative banking channels including digital and agency banking supported this increase in fees and commissions, despite a contraction in the value of total loans issued. The current revenue mix stands at 58:42 funded to non-funded income from 66:34 in H1’2016
- Total operating expenses declined by 1.2% to Kshs 17.6 bn from Kshs 17.8 bn in H1’2016 following a 3.5% y/y decline in Loan Loss Provision to Kshs 1.8 bn from Kshs 1.9 bn. Staff costs also declined by 15.7% to Kshs 5.2 bn from Kshs 6.1 bn in H1'2016. Other expenses increased by 6.1% to Kshs 7.0 bn from Kshs 6.4 bn
- The Cost to Income ratio deteriorated to 57.0% from 55.6% in H1'2016. Without LLP, the Cost to Income ratio worsened to 51.1% from 49.6% in H1'2016
- Profit before tax decreased by 7.4% to Kshs 9.4 bn from Kshs 10.1 bn, while profit after tax decreased by 7.4% to Kshs 9.3 bn from Kshs10.1 bn in H1’2016.

Balance Sheet

- The balance sheet recorded an expansion in H1’2017, with total assets increasing by 13.6% to Kshs 504.9 bn from Kshs 444.4 bn in H1’2016. This growth was driven by a 58.3% increase in investment securities to Kshs 115.6 bn from Kshs 73.0 bn in H1'2016. The loan book however contracted by 1.4% to Kshs 265.1 bn from Kshs 269.0 bn in H1’2016,
- Total liabilities rose by 13.6% to Kshs 419.1 bn from Kshs 369.0 bn in H1'2016, driven by a 13.6% increase in deposits to Kshs 362.8 bn from Kshs 319.2 bn in H1'2016. Shareholders’ funds increased by 13.9% to Kshs 85.9 bn from Kshs 75.4 bn in H1’2016,
- The faster increase in deposits coupled with a decline in the loan book led to a decline in the loan to deposit ratio to 73.1% from 84.3% in H1’2016,
- Gross non-performing loans increased by 57.5% to 20.4 bn from 12.9 bn and NPL ratio increased to 7.6% from 4.7% in H1’2016
- The yield on interest earning assets declined to 12.2% from 13.6% in H1’2016 with the cost of funds declining to 2.7% from 2.9% in H1’2016
- Equity Group is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 15.7%, 5.2% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 9.1%.

- Equity Group currently has a ROA of 3.3% and a ROE of 22.3%

Key Take outs:

i. Change in business model. The tough operating environment experienced by the bank has forced it to adopt a new business model that will focus on, (i) growing non-funded income, (ii) regional diversification, (iii) strengthening liquidity and balance sheet agility, (iv) treasury operations, (v) improving asset quality, (vi) innovation and digitization, and (vii) enhancing efficiencies and cost optimization,

ii. Growth in its Non-Funded income, which currently accounts for 42.0% of its total operating income. With the introduction of the interest rate caps, Equity Group has diversified its revenue sources, especially by investing into government securities, which grew by 122,5% to Kshs 88.1 bn from Kshs 39.6 in HY'2016

iii. Regional Performance, all the bank's subsidiaries had positive growth in y/y pre-tax earnings, in exception of Kenya and South Sudan The subsidiaries contributed to 10% of PBT from 5% in HY'2016. The bank plans to continue with its regional diversification plan, by opening up more subsidiaries as all their current subsidiaries are self-sustainable

iv. As one of the top 3 deposit gatherers in the country, alongside KCB Group and Co-op Bank, it is in their interest to actively lobby for the review of the interest rate cap legislation which is hurting not just industry players, but also the economy and the very consumers it was purportedly meant to help

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	H1'2016	H1'2017	y/y change	H2'2017e	Expected y/y change	Variance in Growth Actual vs. Expected
Government Securities	61.6	105.1	70.7%	107.6	74.8%	4.0%
Net Loans and Advances	269.0	265.1	(1.5%)	269.8	0.3%	1.7%
Total Assets	**444.4**	**504.9**	**13.6%**	**513.9**	**15.6%**	**2.0%**
Customer Deposits	319.2	362.8	13.6%	364.5	14.2%	0.5%
Total Liabilities	369.0	419.1	13.6%	429.8	16.5%	2.9%
Shareholders' Funds	**75.4**	**85.9**	**13.9%**	**84.1**	**11.6%**	**(2.3%)**

Balance Sheet Ratios	H1'2016	H1'2017	% y/y change
Loan to Deposit Ratio	84.3%	73.1%	(11.2%)
Return on average equity	27.9%	22.0%	(6.0%)
Return on average assets	3.5%	3.3%	(0.2%)

Income Statement	H1'2016	H1'2017	y/y change	H1'2017e	Expected y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	21.2	17.9	(15.5%)	19.2	(9.5%)	6.0%
Net non-Interest Income	10.8	13.0	19.6%	11.7	8.0%	(11.6%)
Total Operating income	**32.1**	**30.9**	**(3.6%)**	**30.9**	**(3.6%)**	**0.1%**
Loan Loss provision	(1.9)	(1.9)	(3.5%)	(2.1)	11.2%	14.7%
Total Operating expenses	(17.9)	(17.6)	(1.3%)	(17.3)	(3.0%)	(1.7%)
Profit before tax	14.2	13.3	(6.6%)	13.6	(4.3%)	2.3%
Profit after tax	**10.1**	**9.3**	**(7.4%)**	**9.5**	**(5.4%)**	**1.9%**

Income Statement Ratios	H1'2016	H1'2017	y/y change
Yield from interest-earning assets	7.1%	5.5%	(1.7%)
Cost of funding	2.9%	2.7%	(0.2%)
Cost of risk	6.0%	6.0%	0.0%
Net Interest Spread	10.8%	9.7%	(1.1%)
Net Interest Income as % of operating income	66.2%	58.0%	(8.2%)
Non-Funded Income as a % of operating income	33.8%	42.0%	8.2%
Cost to Income	55.6%	57.0%	1.4%
Cost to Assets	1.4%	3.3%	1.9%

Capital Adequacy Ratios	H1'2016	H1'2017
Core Capital/Total Liabilities	23.4%	22.9%
Minimum Statutory ratio	8.0%	10.5%
Excess	**15.4%**	**12.4%**
Core Capital/Total Risk Weighted Assets	18.7%	19.6%
Minimum Statutory ratio	10.5%	10.5%
Excess	**8.2%**	**9.1%**
Total Capital/Total Risk Weighted Assets	19.8%	20.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	**5.3%**	**5.9%**
Liquidity Ratio	37.0%	51.1%
Minimum Statutory ratio	20.0%	20.0%
Excess	**17.0%**	**31.1%**