

Equity Group Holdings– 1H17 Earnings Update

‘New milestone as total assets surpass KES 0.5 trillion’

Equity Group posted a 7.4% y/y (-6.8%, q/q) decline in 1H17 net earnings to KES 9.3B, after net interest income spiraled down 15.5% y/y (+1.9%, q/q) to KES 17.9B. In line with market expectations, the group did not declare an interim dividend.

Interest income declines on rate cap, loan book contraction

Total interest income fell 11.8% y/y (+0.7%, q/q) to KES 23.0B primarily attributed to a 28.0% y/y drop in interest income from loans and advances. The group’s loan book contracted by a marginal 1.5% y/y to KES 265.1B. SMEs accounted for 61.0% of the loan book (+600 bps y/y) followed by retail borrowers, which comprised of 20.0% (-500 bps y/y) of the loan book. Large corporate entities marked a 6.0% y/y decline, accounting for 33.8% of the group’s loan book.

Interest income from government securities surged 115.8% y/y to KES 6.2B as total funds held in government securities spiked 58.3% y/y to KES 115.6B. The implementation of the rate cap has resulted in the lender diverting excess liquidity to government securities in a bid to bolster the top-line.

Stellar growth in customer deposits increases headroom for loan book expansion

Total interest expenses increased 4.1% y/y (-3.7%, q/q) to KES 5.1B on the back of an 8.4% y/y increase in interest expenses derived from customer deposits. Customer deposits rose 10.5% y/y to KES 325.8B. Interest bearing deposits accounted for 31.0% (+200 bps y/y) of total customer deposits, underscoring the lender’s continued ability to attract cheap non-interest bearing deposits to fund loan book growth. The contraction in loan book, coupled with a marked increase in customer deposits led to a 920bps y/y drop in the group’s loan to deposits ratio to 75.1%.

Non-funded income growth a key positive

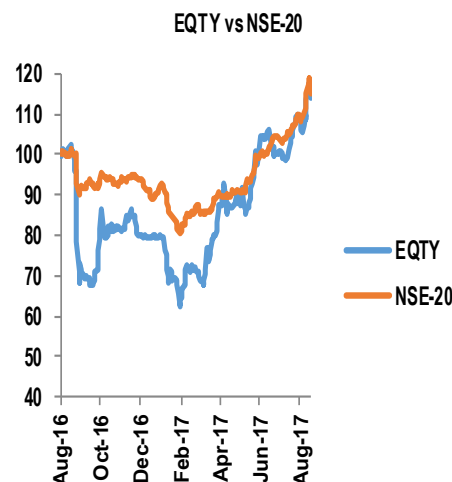
The cap on lending rates in Kenya has forced lenders to explore new ways to grow non-interest income to diversify income streams and reduce reliance on interest income. Equity posted a 19.6% y/y (+4.9%, q/q) rise in non-interest income to KES 12.9B. Gross fees and commission climbed 26.0% y/y to KES 9.4B. Prime drivers for non-funded income growth were mobile banking commission which surged 337.0% y/y to KES 649.7M, agency commission which jumped 27.0% y/y to KES 424.5M and trade finance which rose 25.0% y/y to KES 532.8M. In addition, foreign exchange income boosted non-interest income after increasing 4.0% y/y to KES 1.7B. Non funded income contributed to 42.0% of total income, an increase of 820 bps y/y.

Bloomberg Ticker : EQBNK KN
Reuters Ticker: EQTY.NR

Share Statistics

Current Price (KES)	43.00
Issued shares (M)	3,773
Market cap (USD M)	1,571
Year end	Dec
Foreign ownership (%)	46.5
Free float (%)	81.1
Av daily trading vol (USD)	966.7

Price Trend



Source: Bloomberg

Research Analyst

Shaniza Kassam

skassam@apexafrica.com

+254 788 318950

www.apexafrica.com



Increased use of digital channels boosts efficiency

Total operating expenses remained intact, dipping a marginal 1.0% y/y but rising 9.6% q/q. The group continues to focus on innovation and digitization by moving a bulk of its transactions to non-branch platforms. The group's mobile money platform, Equitel, continued to gain traction, increasing market share (as measured by value of transactions) from 7.4% in 1Q16 to 23.4%, in 1Q17. The bank has recently started closing some of its ATMs as the lender seeks to shift transactions to alternative channels such as agency and mobile banking in a fresh cost-cutting strategy. Management reckons that while ATMs require upfront capital investments to acquire the machines and lease space yet depreciate at 20% annually, agency and mobile banking have no such capital commitments.

Bad loans grow amid macroeconomic challenges

The first half of 2017 saw a decline in business activity, driven by rising food inflation and political uncertainty ahead of the Kenyan General Elections. Consequently, the group reported a 57.5% y/y surge in gross non-performing loans to KES 20.4B. NPLs from large enterprises went up 5.9% y/y, those from SMEs increased 2.8% y/y and NPLs from micro enterprises rose 2.2% y/y.

The bank's NPL ratio stands at 7.5%, up from 3.3% in FY15. The NPL ratio has surged 280 bps y/y and further deterioration in asset quality is expected in the second half of the year. Nonetheless, the bank's coverage ratio remains at a manageable 38.3% (-120 bps y/y) and while we cannot rule out the likelihood of further increase in non-performing loans in 2H17, we see little risk of a systemic deterioration in asset quality within the group's loan book.

Looking Ahead

Going forward, we expect the group to continue leveraging on its shopkeeper-agency and mobile-based payment platforms to efficiently grow its customer base. Furthermore, we expect increased investment and marketing around Equi-

ty Group's increasingly popular online banking app and mobile application, in a bid to improve efficiency.

The digital ecosystem is expected to play an important role in the group's growth strategy going forward, given its significant cost-saving potential.

Equity's title as a bank for the masses remains intact, and we expect the growth in customer deposits witnessed in 1H17 to carry on to the second half of the year, resulting in increased deposit mobilization, which may translate into higher interest income.

However, challenges remain; the cap on lending rates is projected to squeeze margins and impact the bank's lending policies, threatening Equity's successful niche in the retail and SME lending space. Additionally, a surge in bad loans may result in an increase in provisioning costs.

The stock currently trades at 10.1x trailing FY16 earnings and 1.9x trailing FY16 book value, with a dividend yield of 6.7%. The counter remains attractive in light of its growth strategies and cost-cutting measures. However, we perceive the lender to be a bit too pricy at current multiples.

Equity Group Holdings– 1H17 Earnings Update



	1Q16	2Q16	3Q16	4Q16	FY16	1Q17	2Q17	% chg y/y	% chg q/q
Income Statement	KES '000	KES '000	KES '000	KES '000	KES '000	KES '000	KES '000	1H17 vs 1H16	2Q17 vs 1Q17
Interest Income	12,882,251	13,213,492	5,504,797	20,240,064	51,840,604	11,465,047	11,540,145	-11.8%	0.7%
Interest Expense	2,449,322	2,413,662	1,137,040	4,026,688	10,026,712	2,579,091	2,483,449	4.1%	-3.7%
Net Interest Income	10,432,929	10,799,830	4,367,757	16,213,376	41,813,892	8,885,956	9,056,696	-15.5%	1.9%
Foreign Exchange Income	842,417	812,610	921,985	730,101	3,307,113	916,587	804,839	4.0%	-12.2%
Gross Fees and Commission	3,542,586	3,713,966	5,084,932	3,439,588	15,781,092	4,485,104	4,656,323	26.0%	3.8%
Other Income	828,161	1,108,164	-48,596	1,242,850	3,130,579	931,604	1,182,167	9.2%	26.9%
Non Interest Income	5,213,164	5,634,760	5,958,321	5,412,539	22,218,784	6,333,295	6,643,329	19.6%	4.9%
Total Operating Income	15,646,093	16,434,590	10,326,078	21,625,915	64,032,676	15,219,251	15,700,025	-3.6%	3.2%
Total Operating Expenses	7,653,935	8,268,617	8,252,918	8,284,683	32,460,153	7,521,570	8,245,146	-1.0%	9.6%
Loan Loss Provision Expense	704,919	1,223,136	-231,726	4,949,312	6,645,641	796,900	1,063,444	-3.5%	33.4%
Operating Profit	7,287,239	6,942,837	4,001,215	6,695,591	24,926,882	6,900,781	6,391,435	-6.6%	-7.4%
Profit Before Tax and exceptional Items	7,287,239	6,942,837	4,001,217	6,695,589	24,926,882	6,900,781	6,391,435	-6.6%	-7.4%
Tax	2,150,366	1,968,401	1,210,381	2,995,206	8,324,354	2,050,660	1,880,078	-4.6%	-8.3%
Profit After Tax	5,136,873	4,974,436	2,790,836	3,700,383	16,602,528	4,850,121	4,511,357	-7.4%	-7.0%
Minority Interest	4,718	26,656	60,160	-34,799	56,735	17,461	5,333	-27.3%	-69.5%
Profit After Tax and Minority Interest	5,132,155	4,947,780	2,730,676	3,735,182	16,545,793	4,832,660	4,506,024	-7.4%	-6.8%
EPS (KES)	1.36	1.31	0.73	0.98	4.38	1.28	1.19	-7.5%	-7.0%
DPS (KES)					2.00				
No. of Shares	3,773,674	3,773,674	3,773,674	3,773,674	3,773,674				
Balance Sheet									
Total Shareholders' Equity	69,115,922	75,404,004	81,601,229	81,977,096	81,977,096	79,439,339	85,893,664	13.9%	8.1%
Deposits due to Banks & Financial Institutions	1,118,210	1,532,718	58,614	5,193	5,193	1,767,622	846,163	-44.8%	-52.1%
Borrowed Funds	39,871,970	38,519,736	45,056,987	45,770,072	45,770,072	44,480,018	43,532,545		
Customer Deposits	299,219,415	319,230,725	331,298,440	337,198,618	337,198,618	347,514,400	352,788,342	13.6%	1.5%
Total Liabilities	361,071,273	369,032,846	386,445,334	391,736,036	391,736,036	412,714,127	419,050,629	13.6%	1.5%
Total Equity and Liabilities	430,187,195	444,436,850	468,046,563	473,713,132	473,713,132	492,153,466	504,944,293	13.6%	2.6%
Cash and CBK Balances	24,225,858	29,882,289	25,103,154	23,391,567	23,391,567	30,670,821	33,045,799	10.6%	7.7%
Balances due from Banks & Financial Institutions	24,057,344	29,878,307	33,607,039	41,054,560	41,054,560	42,022,118	44,741,638	49.7%	6.5%
Government and Other Securities	62,385,083	33,032,067	30,143,777	100,588,954	100,588,954	112,988,818	115,595,812	58.3%	2.3%
Net Loans and Advances	275,017,411	269,032,284	271,380,618	266,068,089	266,068,089	261,899,197	265,086,161	-1.5%	1.2%
Fixed Assets	13,857,056	14,286,778	13,578,332	13,754,329	13,754,329	13,345,923	13,004,808	-9.0%	-2.6%
Total Assets	430,187,195	444,436,850	468,046,563	473,713,133	473,713,133	492,153,465	504,944,293	13.6%	2.6%
Key Ratios									
Gross NPL (KES M)	10,915,628	12,931,302	16,493,169	18,754,023	18,754,023	19,509,295	20,363,500	57.5%	4.4%
Interest In Suspense (KES M)	1,882,217	2,173,547	2,697,533	2,036,824	2,036,824	2,333,688	2,867,909	31.9%	22.9%
Total NPL (KES M)	9,033,411	10,757,755	13,795,636	16,717,199	16,717,199	17,175,607	17,495,591	62.6%	1.9%
Loan Loss Provision (KES M)	4,228,285	4,799,629	5,597,639	6,959,640	6,959,640	7,069,507	7,801,417	62.5%	10.4%
Net NPL	4,805,126	5,958,126	8,197,997	9,757,559	9,757,559	10,106,100	9,694,174	62.7%	-4.1%
NPL Ratio	3.9%	4.7%	6.0%	6.9%	6.9%	7.3%	7.5%		
Coverage Ratio	38.7%	37.1%	33.9%	37.1%	37.1%	36.2%	38.3%		
Cost of Risk	1.0%	1.8%	-0.3%	7.4%	2.5%	1.2%	1.6%		
Loan to Deposits	91.9%	84.3%	81.9%	78.9%	78.9%	75.4%	75.1%		
Yield on Interest Earning Assets	14.3%	15.9%	6.6%	19.9%	12.7%	11.0%	10.9%		
Cost of Funds	0.7%	0.7%	0.3%	1.1%	2.6%	0.7%	0.6%		
NIM	13.5%	15.3%	6.3%	18.8%	10.1%	10.3%	10.2%		
Non Funded/Total Income	33.3%	34.3%	57.7%	25.0%	34.7%	41.6%	42.3%		
Cost to Income Ratio	44.4%	42.9%	82.2%	15.4%	40.3%	44.2%	45.7%		
ROE	29.7%	26.4%	13.7%	18.1%	20.3%	24.4%	21.0%		
ROA	4.8%	4.5%	0.6%	0.8%	3.5%	3.9%	3.6%		
Core Capital/TRWA	18.3%	14.4%	14.7%	18.7%	18.7%	19.3%	19.3%		
Total Capital/TRWA	19.6%	15.6%	15.7%	19.7%	19.7%	20.2%	20.2%		
Liquidity Ratio	34.9%	39.9%	44.8%	47.6%	47.6%	50.6%	50.6%		
EPS (KES)					4.26				
DPS (KES)					2.00				
BVPS					22.76				
P/E (x)					10.1				
P/B (x)					1.9				
Dividend Yield					6.7%				

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ApexAfrica Capital Ltd
A The Riverfront, 1st Floor, Prof. David Wasawo Drive, Off Riverside Drive | P.O. Box 43676-00100 | Nairobi | Kenya |
T: +254-20-2226440 | **Fax**: +254-20-2319092 | **Cell**: +254-723-420204|
W : www.apexafrica.com
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W : www.axys-group.com