

Valuation Summary

- Equity Group Holdings is currently trading at a P/B of 2.1x and a P/E of 8.7x, versus an industry average of 1.6x and 7.8x, respectively
- We recommend a BUY for the Equity Group Holdings stock with a target price of Kshs. 48.6, representing an upside of 23.4% from the current price of Kshs 40.8, as at 9th March 2016, inclusive of a dividend yield of 4.1%

Key highlights during the year – 2015

- Dr. James Mwangi, Equity Group Holdings CEO's tenure was extended for 10 years to 2025. We believe this is a good initiative as he has ran the bank successfully through its Equity 1.0 and Equity 2.0 strategy, thus making him the ideal man to complete Equity's 3.0 strategy
- Helios exited its 24.4% stake in Equity Bank, posting an annualized return of 31.0%, subsequently making Norfund, a Norwegian Private Equity firm the largest shareholder with 12.2%
- Equity Group appointed Bhartesh Shah as Chief Operating Officer, having previously served as the Group Director of Operations
- Equity Group Holdings finalized the acquisition of a 79% stake of Pro Credit bank through a share purchase agreement with the owners of Pro Credit Bank where they were issued 70,897,782 of Equity Holdings Shares. Since the acquisition, DRC now contributes 0.8% of the profits and 6.2% of the total Groups assets. A point to note is that, with under a month of operation, DRC now contributes half as much as S.Sudan in the overall Group's profits, with S. Sudan contributing 1.6%, and is positioned well to surpass S. Sudan in profitability this year
- The bank launched the Equitel Platform, which serves as a platform where the core banking services can be offered at the convenience of the customers while reducing operational costs associated with branch operations. Since its launch, the Equitel platform has outperformed expectations;
 - Transaction numbers via mobile banking have increased 999% to 151 mn transactions in 2015 from 13.7 mn transactions in 2014
 - Transaction value has increased 2,353% to Kshs. 114.9 bn in 2015 from Kshs. 4.7 bn in 2014
 - 30% of the total loan portfolio is now being processed via the Equitel platform

Income Statement:

- Earnings per share grew by 1.0% compared to an average EPS growth of 70.7% driven by higher operating expenses growth of 21.8% outpacing the 17.7% growth in operating revenues.
- FY'2015 PAT growth came in lower than our estimates (1.0% y/y growth to Kshs. 17.3 bn from Kshs. 17.2 bn compared to our projection of a 7.7% decline). Adjusted PAT growth, stripping off the one off gain from disposal of associate, the PAT growth comes to 7.7%. The disparity was mainly due to a higher operating expenses growth of 21.8% to Kshs. 32.1 bn in 2015 from Kshs. 26.3 bn in 2014 vs our projection of a 15.2% increase. This was driven by loan loss provision which increased by 53.0% to Kshs. 2.4 bn in 2015 from Kshs. 1.6 bn in 2014 vs our projections of a 35.7% growth. However, for the first time, the bank recorded a decline in staff costs by 4.5% to Kshs. 10.3 bn in 2015 from Kshs. 10.8 bn in 2014. This was due to the Equitel platform that rendered a percentage of staff irrelevant, and due to natural attrition, 600 staff members left

- Net interest income rose by 17.0% y/y to Kshs 34.1 bn, from Kshs 29.2 bn in 2014, against our projections of a 13.0% growth. Interest income recorded a growth of 22.9% to Kshs 43.5 bn in 2015 from Kshs 35.4 bn in 2014 due to a strong customer loans and advances growth of 26.0% to Kshs 269.9 bn from Kshs 214.2 bn. This was largely driven by the Equitel platform which facilitated the roll out of 30% of the total loan portfolio. Interest expenses however grew by 50.0% to Kshs 9.3 bn in 2014 from Kshs 6.2 bn in 2014 driven by a strong customer deposit growth of 23.1% y/y to Kshs 302.2 bn in 2015 from Kshs. 245.4 bn in 2014
- Non-funded income increased by 18.8% to Kshs 34.1 bn in 2015 from Kshs 21.9 bn in 2014, lower than our projection of a 28.9% increase
- The current revenue mix stands at 60.9%:39.1% funded to non-funded income respectively, and we expect this mix to narrow down in the next few years as they grow their non-funded income through transactional fees via their Equitel Platform, Insurance Agency and Investment Banking
- Operating income grew by 17.7% y/y to Kshs 56.1 bn in 2015 from Kshs. 47.6 bn in 2014 compared to our projections of a 19.1% y/y increase
- Total operating expenses grew by 21.8% to Kshs 32.1 bn in 2015 from Kshs. 26.3 bn compared to our projection of a 15.2% growth, resulting into a cost to income ratio increasing to 52.9% from 52.0% in 2014 vs an industry average of 48.7%. We however believe that this will soon normalize as they are in an investment phase and will incur huge costs associated with IT upgrading of their systems associated with the Equitel rollout
- The adjusted earnings per share (adjusted to the current number of shares) grew by 1.0% y/y to Kshs 4.6 in 2015 from Kshs 4.5 in 2014
- The management recommended a dividend per of Kshs 2.0, a payout of 43.6% compared to 39.6% in 2014 resulting into a dividend yield of 4.1%

Balance Sheet:

- Customer deposits increased by 23.1% y/y to Kshs 302.2 bn compared to our growth projection of a 35.3% growth. Deposits per branch increased by 15.5% from Kshs. 1.1 bn per branch in 2014 to Kshs. 1.2 bn per branch. This was due to an increment of the number of branches by 15 to 243 branches owing to the acquisition of Pro Credit Bank Congo. Loan growth outpaced deposit growth resulting into a loan to Deposit ratio of 89.3% from 87.3% in 2014
- Total liabilities increased by 26.8% to Kshs 355.9 bn. Shareholders' funds increased by 13.1% y/y to Kshs 72.1 bn. The cost of funds increased to 3.0% from 2.5% in the FY' 2014 results
- Return on equity declined to 25.5% from 29.7% in 2014 while return on Assets came in at 4.5% from 5.5% in 2014

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	FY'2014	FY'2015	y/y change	FY'2015e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	48.37	42.78	(11.56%)	49.78	2.93%	14.49%
Net Loans and Advances	214.17	269.89	26.02%	265.52	23.98%	(2.04%)
Total Assets	344.59	428.06	24.22%	452.25	31.24%	7.02%
Customer Deposits	245.38	302.17	23.14%	331.90	35.26%	12.12%
Total Liabilities	280.80	355.93	26.76%	382.83	36.34%	9.58%
Shareholders' Funds	63.78	72.14	13.11%	69.43	8.86%	(4.25%)

Balance Sheet Ratios	FY'2014	FY'2015
Loan to Deposit Ratio	87.28%	89.32%
Return on average equity	29.74%	25.50%
Return on average assets	5.51%	4.49%

Income Statement	FY'2014	FY'2015	y/y change	FY'2015e	% y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	29.17	34.12	16.96%	32.97	12.99%	(3.97%)
Net non-Interest Income	18.47	21.94	18.76%	23.81	28.87%	10.12%
Total Operating income	47.65	56.06	17.66%	56.77	19.15%	1.49%
Loan Loss provision	1.59	2.43	52.95%	2.16	35.69%	(17.26%)
Total Operating expenses	26.35	32.10	21.85%	30.35	15.19%	(6.66%)
Profit before tax	22.36	23.96	7.13%	26.42	18.15%	11.02%
Profit after tax	17.15	17.33	1.02%	18.50	7.84%	6.81%

Income Statement Ratios	FY'2014	FY'2015	y/y change
Yield from interest-earning assets	13.28%	13.49%	1.56%
Cost of funding	2.49%	3.00%	20.50%
Net Interest Spread	10.79%	10.49%	(2.81%)
Net Interest Income as % of operating income	61.23%	60.87%	(0.59%)
Non-Funded Income as a % of operating income	38.77%	39.13%	0.93%
Cost to Income	51.96%	52.93%	1.86%
Cost to Assets	7.18%	6.93%	(3.52%)

Capital Adequacy Ratios	FY'14	FY'15
Core Capital/Total Liabilities	23.20%	23.10%
Minimum Statutory ratio	8.00%	8.00%
Excess	15.20%	15.10%
Core Capital/Total Risk Weighted Assets	18.90%	18.70%
Minimum Statutory ratio	10.50%	10.50%
Excess	8.40%	8.20%
Total Capital/Total Risk Weighted Assets	21.20%	20.20%
Minimum Statutory ratio	14.50%	14.50%
Excess	6.70%	5.70%
Liquidity Ratio	39.60%	33.20%
Minimum Statutory ratio	20.00%	20.00%
Excess	19.60%	13.20%

10 Year Income Analysis

For the past 10 years, Equity Group Holdings has recorded and average an EPS growth of 70.7%. In 2015 they recorded the slowest adjusted EPS growth in 10 years of 1.0%

Income Statement (Kshs bns)	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	CAGR
Interest Income	0.95	1.63	3.25	7.98	10.79	13.78	19.34	30.85	31.89	35.37	43.45	41.6%
Net interest Income	0.87	1.51	2.76	6.62	9.17	11.71	16.22	23.96	26.49	29.17	34.12	39.7%
Non-interest income	0.94	1.86	3.06	5.99	6.51	10.44	12.45	12.86	15.37	18.47	21.94	33.2%
Operating income	1.80	3.37	5.82	12.61	15.68	22.15	28.67	36.83	41.86	47.65	56.06	36.7%
Loan loss provision	0.12	0.13	(0.03)	1.02	1.04	1.90	1.63	1.61	2.40	1.59	2.43	31.0%
Operating expenses	1.30	2.27	3.46	7.62	10.46	13.20	15.99	19.58	22.71	26.35	32.10	33.8%
PBT	0.50	1.10	2.36	4.99	5.22	9.04	12.83	17.42	19.00	22.36	23.96	42.1%
Reported PAT	0.34	0.75	1.89	3.91	4.23	7.08	10.33	12.08	13.28	17.15	17.33	42.8%
Reported PAT Growth	153.13%	118.62%	150.91%	106.86%	8.28%	67.23%	45.82%	17.00%	9.91%	29.17%	1.02%	
Reported EPS	1.25	2.77	6.88	1.06	1.14	1.93	2.79	3.26	3.59	4.63	4.59	12.6%
Reported EPS Growth	152.51%	121.60%	148.38%	(84.59%)	7.55%	69.30%	44.56%	16.85%	10.12%	28.97%	(0.86%)	
Adjusted EPS	0.09	0.20	0.50	1.04	1.12	1.88	2.74	3.20	3.52	4.54	4.59	42.8%
Adjusted EPS Growth	153.13%	118.62%	150.91%	106.86%	8.28%	67.23%	45.82%	17.00%	9.91%	29.17%	1.02%	