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Equity Bank-FY2012 Results Note

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RECOMMENDATION: BUY

Current Market Price (08.03.13)	30.00
Trailing BVPS:2012	11.59
Trailing P/B	2.59
Forecasted BVPS: 2013	15.09
Target Price	**39.07**
Upside Potential	**30.2%**

Share Statistics

Issued Shares (Mn)	3,703
Market Cap (Kshs Mn)	104,610
Market Cap (USD Mn)	1,214.08
Free Float	44.30%

Source: NSE

Summary

We revise our earlier rating from a **NEUTRAL** recommendation to a **BUY** recommendation, based on our price target of KES 39.07, which provides a 30.2% upside potential from the prevailing market price (as at March 8, 2013. Our price target was arrived at based on the bank's trailing P/B and forecasted 2013 BVPS.

Key results highlights are outlined in the report.

Key Milestones

Growth in agency network and transactions: The number of agents grew by 90.0% from 3,339 agents in January 2012 to 6,344 in December 2012.

Tapping into diaspora remittances: Equity commands a market share of 13.0% of the diaspora remittances.

Rising commission income from merchant business: The total turnover of merchant business grew from about KES 150 million to KES 1.3 billion by the end of the year. Out of this, commission income derived from the merchant business grew from less than KES 5 million to stand at the current levels of about KES 30 million per month.

Outlook

Slowing lending momentum: We are beginning to see a slowdown in the growth of the loan book. A growth of 19.2% compares dismally with previous years.

Regional expansion: By June 2012, Equity had invested close to KES 7.1 billion in Uganda (68%), South Sudan (17.4%) and Rwanda (14.6%). However, the cumulative return on invested capital was -15.6% (Uganda), 73.7% (South Sudan) and -5.7% (Rwanda). We are still keen on the performance of the regional subsidiaries

Year to 31 Dec	2011A	2012A	2013F
Net Income (KES Mn)	10,325	12,080	16,077
EPS (KES	2.79	3.26	4.34
BVPS (KES)	9.3	11.6	15.1
P/E x	10.76	9.20	6.91
P/B x	3.2	2.6	2.0
ROE	30.0%	28.1%	28.8%
ROA	5.3%	5.0%	5.6%
C/I Ratio	50.1%	49.0%	47.4%

Results Highlights

Equity Bank FY2012 Income statement (Kshs '000)	FY2011	FY2012	% change
Interest income	19,339,571	30,847,947	*59.5%*
Interest expenses	3,116,534	6,883,814	*120.9%*
Net interest income	**16,223,037**	**23,964,133**	***47.7%***
Non-interest income	**12,447,008**	**12,863,346**	***3.3%***
Total operating income	28,670,045	36,827,479	*28.5%*
Operating expenses	14,361,254	17,970,489	*25.1%*
Loan loss provision	1,629,648	1,608,316	*-1.3%*
Profit Before Tax	**12,679,143**	**17,248,674**	***36.0%***
Profit After Tax	**10,325,157**	**12,080,255**	***17.0%***
EPS	***2.79***	***3.26***	
Yield on loans	***14.6%***	***20.2%***	
Cost of customer funds	***1.5%***	***3.1%***	
Cost to income ratio	***50.1%***	***48.8%***	

Sources: Company releases, FIB analysis

Balance Sheet (Kshs '000)	FY2011	FY2012	% change
Total Assets	**196,293,897**	**243,170,458**	***23.9%***
Loan book	113,823,792	135,692,125	*19.2%*
Government securities	22,616,694	22,844,379	*1.0%*
Government & other securities held for dealing	7,594,887	9,993,377	*31.6%*
Foreign currency T-bills	26,301	7,959,084	*30161.5%*
Deposits & balances due from local banking institutions	1,734,925	9,997,868	*476.3%*
Deposits & balances due from foreign institutions	17,814,951	14,037,451	*-21.2%*
Total Liabilities	**162,008,348**	**200,254,070**	***23.6%***
Customer deposits	*140,446,501*	*165,812,458*	*18.1%*
Borrowed funds	*14,792,277*	*26,568,809*	*79.6%*
Shareholders' funds	**34,285,547**	**42,916,388**	***25.2%***
Core capital/total risk weighted assets	***13.6%***	***17.6%***	
Liquidity ratio	***37.0%***	***46.0%***	

Sources: Company releases, FIB analysis

Growth in PBT 10.3% higher than earlier projected

PBT growth, 10.3% higher than projected: Equity Bank's profit before tax (PBT) grew by 36.0% from KES 12.7 billion (FY2011) to KES 17.2 billion (FY2012).

We had projected a growth of 25.7% (10.3% variance) to KES 15.9 billion in FY2012, during our Banking Sector Report 2012, dubbed The Innovation Imperative. Key reasons for this variance include a forecasted lower loan book growth compared to the actual and a higher level of provisions compared to the actual.

FY2012 PAT up 17.0% to KES 12.1 billion

Profit after tax (PAT) rose by 17.0% from KES 10.3 billion (FY2011) to KES 12.1 billion (FY2012). In our earlier report, we had forecasted that PAT would grow to KES 11.3 billion in FY2012.

59.5% growth in total interest income within expectations

59.5% growth in total interest income, within expectations: Equity's total interest income grew by 59.5% from KES 19.3 billion (FY2011) to KES 30.8 billion (FY2012). This was slightly above expected growth of 52.4% to KES 29.5 billion, but still within our expectations.

Interest income driven by the growth in loan book and rise in yields on loans

Growth in loan book, yield on loans drives interest income: The growth in interest income was mainly driven by a 19.2% (compared to our forecast of 16.8%) growth in loan book and an increase in interest income yields. The average yield on loans and advances rose from 14.6% (FY2011) to 20.2% (FY2012). The average interest income yield on government securities rose marginally from 8.8% (FY2011) to 9.2% (FY2012). The yield on balances with other banks rose from 0.4% to 1.1% during the year under review. During the year in review, the average lending rate of the banking universe in Kenya declined only marginally from 19.5% January to 18.2% in December.

120.9% jump in interest expense in line with our forecasts

120.9% jump in interest expense, in line with our forecasts: Interest expense rose by 120.9% from KES 3.1 billion in FY2011 to KES 6.88 billion in FY2012 (compared to our forecasted growth of 122.3% to KES 6.93 billion.

During the period in review, there was competition for funds. Banks were forced to offer relatively higher rates on customer deposits to avoid the flight of funds from their customer deposits base. In addition, attractive and high yielding fixed income securities excercebated this situation.

Average cost of customer deposits up from 1.5% to 3.1%

The average cost of customer deposits rose from 1.5% (FY2011) to 3.1% (FY2012). As a result, interest expense on customer deposits rose from 2.1 billion (FY2011) to KES 5.2 billion (FY2012). The average cost of deposits due to other banks jumped from 4.8% in FY2011 to 12.3% in FY2012. This resulted in a 44.4% increase in interest expense on these placements from KES 179 million (FY2011) to 259 million (FY2012).

Although the average cost of borrowings remained fairly flat at about 5.5%, interest paid increased by 80.9% (from KES 806 million to KES 1.5 billion), mainly due to a 79.6% rise in borrowings to KES 26.6 billion.

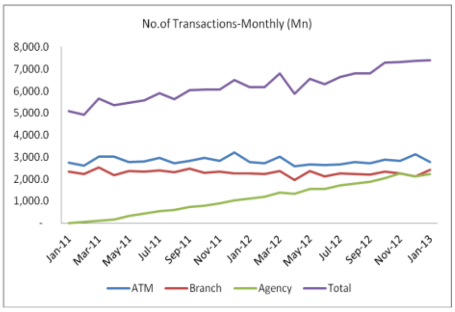
GNPL/gross loans up 30 basis points to 3.1%

Slight deterioration in loan book quality: The gross non-performing loans/gross loans (GNPLs/Gross loans) increased from 2.8% (FY2011) to 3.1% (FY2012). During the year, the loan book grew by 19.2% to KES 135.7 billion. Majority of the non-performing loans were from Consumers (KES 1.8 billion), Micro Enterprises (KES 1.1 billion), SMEs (KES 1.1 billion).

Total capital/total risk weighted assets increased from 21.7% to 30.1%

Improvement in key capital adequacy ratios: The core capital/total deposit liabilities increased from 13.6% (FY2011) to 17.6% (FY2012). The core capital/total risk weighted assets rose from 15.4% (FY2011) to 19.9% (FY2012). The total capital/total risk weighted assets also increased from 21.7% (FY2011) to 30.1% (FY2012).

Key Milestones



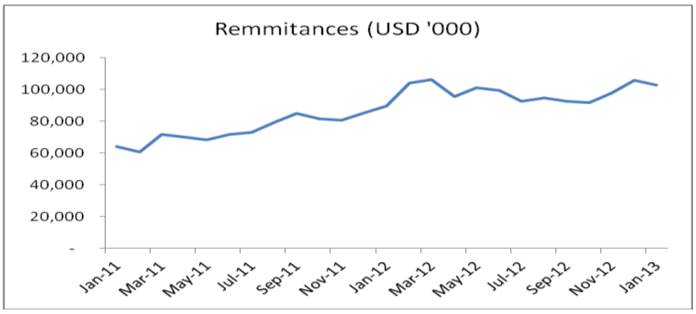
Growth in agency network and transactions: The bank has continued to grow its agency network coverage across the country. The number of agents grew by 90.0% from 3,339 agents in January 2012 to 6,344 in December 2012. The total value of deposits transactions collected by agents grew from KES 4.5 billion in December 2011 to KES 9.8 billion in December 2012. The total value of withdrawals was less, and grew from KES 2.6 billion in December 2011 to KES 4.8 billion.

On a net basis, the spread between deposits and withdrawals continues to widen, increasing from KES 1.8 billion at the beginning of the review period to KES 5.0 billion. This implies two things. First, that the agents are increasingly becoming strategic collection points which are helping boost the inflow of deposits to the bank. Secondly, agents are becoming a significant source of non-funded income to the bank.

The level of activity carried at the agency level is now matching that being conducted at the branch level.

Equity now commands 13.0% market shares of the diaspora remittances

Tapping into diaspora remittances: Equity commands a market share of 13.0%. We expect growth in this market segment to continue, based on product and service offering. The total diaspora remittances in 2012 stood at USD 1.2 billion compared to USD 891 million recorded in the previous year.



Commission income from merchant business now at KES 30 million per month

Rising commission income from merchant business: During the year in review, the total turnover of merchant business grew from about KES 150 million at the beginning of the year to KES 1.3 billion by the end of the year. Out of this, commission income derived from the merchant business grew from less than KES 5 million at the beginning of the year to stand at the current levels of about KES 30 million per month. Equity Bank has partnerships with firms that handle various forms of payments such as Visa Card, Master Card and China Union.

Outlook

Loan book growth seems to be slowing down

Slowing lending momentum: Over the last 5 years, Equity has managed to grow its loan book by 207.9% from KES 44.1 billion (FY2008) to KES 135.7 billion (FY2012). The base is now relatively large and we are beginning to see a slowdown in the growth of the loan book. A growth of 19.2% compares dismally with previous years.

In our view, we think that the general growth momentum of the bank is slowing down. Seizing new growth opportunities will be instrumental in maintaining the profitability of the bank going forward.

We remain keen on the performance of the regional subsidiaries

Regional expansion: The bank has a presence in Uganda, South Sudan, Rwanda and Tanzania. As earlier alluded to in our Initiation of Coverage Banking Sector Report 2012, return on invested capital across the region has not been impressive.

By June 2012, Equity had invested close to KES 7.1 billion in Uganda (68%), South Sudan (17.4%) and Rwanda (14.6%). However, the cumulative return on invested capital was -15.6% (Uganda), 73.7% (South Sudan) and -5.7% (Rwanda). We are still keen on the performance of the regional subsidiaries.