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Equity Bank-FY2013 Results Note

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RECOMMENDATION: BUY

Current Market Price (28.02.14)	32.25
Trailing BVPS:FY2013	13.92
Trailing P/B	2.32
Forecasted BVPS: FY2014	17.01
Target Price	**39.41**
Upside Potential	**22.2%**

Share Statistics

Issued Shares (Mn)	3,703
Market Cap (Kshs Mn)	119,422
Market Cap (USD Mn)*	1,383.00

Source: NSE

*1 USD= KES 86.35

Summary

We maintain our **BUY recommendation** on Equity Bank, based on a price target of KES 39.41 (a 22.26% upside potential). We expect the evolving strategy to be the bank's next source of growth.

Key Highlights

- **Deposit mobilization below forecast (17.0% vs 15.9%):** Overall, the bank's deposit mobilization in FY2013 fell short compared to our forecast.
- **Better than expected growth in loan book:** The bank grew its loan book by 26.3%, compared to our forecast of 20.2%.
- **114.4% rise in GNPLs:** Asset quality improved quarter-on-quarter (q/q), with the gross non-performing loan (GNPL) ratio improving slightly to 5.2% (4Q2013) compared with 5.5% (3Q2013). However, we note the 114.4% growth in GNPL to KES 9.2 billion year-on-year (y/y).

Outlook

- **Growth consolidation:** We maintain that management's intention of concentrating on growth consolidation will give them a better focus in identifying more opportunities that exist, especially in the domestic market.
- **Growth in agency network and transactions:** The bank has continued to grow its agency network coverage across the country.

Year to 31 Dec	2013A	2014F
Net Income (Kshs Mn)	12,731	14,666
EPS	3.44	3.96
BVPS	13.9	17.0
P/E x	9.38	8.14
P/B x	2.3	1.9
ROaE	27.0%	25.6%
ROaA	4.9%	4.9%
C/I Ratio	48.9%	51.9%

Sources: Company reports, FIB Estimates

Results Highlights

Income Statement (KES Mn)	2012A	2013F	Growth
Interest income	30,848	31,889	3.4%
Interest expense	(6,884)	(5,399)	-21.6%
Net interest income	**23,964**	**26,491**	**10.5%**
Total operating income	**36,827**	**41,861**	**13.7%**
Impairment loss on financial assets	1,608	2,402	49.4%
Personnel expenses	7,145	9,024	26.3%
Total expenses	**17,970**	**22,710**	**26.4%**
Profit before tax & share of associate	17,249	19,151	11.0%
Profit before tax plus share of associate	**17,420**	**19,004**	**9.1%**
Profit for the year	**12,080**	**13,278**	**9.9%**

Sources: Company releases, FIB analysis

Balance Sheet Items (KES Mn)	2012A	2013F	Growth (%)
Loans and advances to customers	135,692	171,364	26.3%
Investment securities	41,100	44,572	8.4%
Property and equipment	9,072	9,795	8.0%
Intangible Assets	1,415	4,166	194.4%
Other assets	7,243	11,141	53.8%
Total Assets	**243,371**	**277,728**	**14.1%**
LIABLITIES			
Deposits from customers	167,913	194,621	15.9%
Other borrowed funds	26,568	26,731	0.6%
Other liabilities	3,369	4,198	24.6%
Total Liabilities	**200,455**	**226,173**	**12.8%**
EQUITY			
Share capital	1,851	1,851	0.0%
Share premium	12,161	12,161	0.0%
Reserves	(813)	119	-114.6%
Retained earnings	25,088	32,590	29.9%
Proposed dividends	4,629	5,179	11.9%
Total Equity	**42,916**	**51,556**	**20.1%**

Sources: Company releases, FIB analysis

Growth in actual PBT at 11.0% vs a forecast of 3.6%

Equity Bank recorded an 11.0% growth in profit before tax (PBT) from KES 17.2 billion (FY2012) to KES 19.2 billion (FY2013). We had forecasted a KES 17.9 billion in PBT. The variance resulted from our relatively high forecast in loan loss provision and a lower projection in non-funded income.

The bank's FY2013 performance was characterized by the following:

Growth in deposits below forecast by 1.1%

Deposit mobilization below forecast (17.0% vs 15.9%): Overall, the bank's deposit mobilization in FY2013 fell short compared to our forecast. We had forecasted a growth of 17.0%, compared to the actual growth of 15.9%. This was despite growth of customer numbers by 600,000 (to 8.4 million), agents network by 3,960 (to 10,200). We expect to see a continued modest growth in customer deposits. We forecast a 17.0% growth in customer deposits for FY2014, to KES 227.7 billion.

Better than expected performance in loan book growth

Better than expected growth in loan book: The bank grew its loan book by 26.3%, compared to our forecast of 20.2%. This was mainly driven by the SMEs, resulting in a 13.0% increase in the number of the loan accounts. We expect this to be a key driving factor in the medium term, as the bank continues to increase its loan book exposure to the SMEs.

A drop in lending rates impacts interest income

Growth in interest income negatively impacted by lower rates: Interest income grew by only 3.4% (to KES 31.9 billion), which was slightly higher than our 2.4% (to KES 31.6 billion) forecast. According to management, interest rates declined by 800 bps to 16.0% by the end of the year. As a result, net interest margin dropped from 13.0% (FY2012) to 12.0% (FY2013). However, management expects to start reaping the benefits of the growth in the loan book in the current year. Going forward, we expect the bank to ride on the ability to push through volumes coupled with high interest margins from the SMEs.

Growing GNPLs

114.4% rise in GNPLs: Asset quality improved quarter-on-quarter (q/q), with the gross non-performing loan (GNPL) ratio improving slightly to 5.2% (4Q2013) compared with 5.5% (3Q2013). However, we note the 114.4% growth in GNPL to KES 9.2 billion year-on-year (y/y). Coverage ratio rose by 110 bps to 53.4% (4Q2013), slightly above the minimum requirement of 52.3%. The rise in GNPL was attributed to the government's delayed payments to SMEs, continued strain in South Sudan arising from oil exportation challenges and new prudential guidelines requiring longer observation periods. We expect the GNPLs to remain relatively high compared to other banks considering the bank's growing bias towards SMEs.

Capital adequacy buffer

Rise in core capital ratio, q/q: The core capital/total risk weighted asset grew from 14.9% (3Q2013) to 18.6% (4Q2013). According to the Central Bank of Kenya (CBK) prudential guidelines, the core capital adequacy ratio was increased by 250 bps to 10.5%.

Outlook

We forecast a 17.0% growth in deposits (FY2014)

Aggressive deposit mobilization: Through the agency model, enhancement of business lines, on-line and mobile application platforms, we expect Equity Bank to continue to grow its deposit base at double digits in the medium term.

Growth consolidation dividend

Growth consolidation: The domestic market continues to account for the lion share of the Group's regional business, 88.7% (loan book) and 81.5% (customer funding). We maintain that management's intention of concentrating on growth consolidation will give them a better focus in identifying more opportunities that exist, especially in the domestic market.

Agency banking to be a key source of growth

Growth in agency network and transactions: The bank has continued to grow its agency network coverage across the country. By the end of the year, the number of agents grew by 3,960 (to 10,200). In addition, the bank rolled out the same in Rwanda and Tanzania. Regulation to introduce the same in Uganda is in progress.

The number of transactions by the agents now account for 1/3 (amounting to about KES 200 billion) of the bank's total transactions. Management expects this to rise, thereby continuing to increase non-funded income.

Growing market share in Diaspora remittances

Tapping into diaspora remittances: Equity's market share for diaspora remittances grew from 14.0% (May 2013) to 16.0% (FY2013). In FY2013, USD 185 million was channeled into the country via Equity Bank. We expect growing competition as other non-banking institutions such as Safaricom are also targeting the same flows.

Recommendation

Rating: Maintaining our BUY recommendation

We maintain our **BUY recommendation** on Equity Bank, based on a price target of KES 39.41 (a 22.26% upside potential). We expect the evolving strategy to be the bank's next source of growth.