Equity Bank-ATML deal negative in the short-term

Equity Group Holdings announced plans to enter into a share swap to exchange certain banking assets of Atlas Mara Limited (ATML) in four countries for share in Equity Group Holdings:

- 62% of the shares of Banque Populaire du Rwanda Ltd
- 100% share of African Banking Corporation Zambia
- 100% of African Banking Corporation Tanzania
- 100% share of African Banking Corporation Mozambique

Equity expects to allot c252,482,300 (6.27% of issued capital) new share translating into KES 10.5bn.

Possible impact

This deal will increase Equity Bank's presence in Africa. Equity's success in Kenya was driven by its model of reaching the unbanked population, a strategy which could be replicated in other African countries.

Equity Bank could add value in the following ways:

- **Growth of the Non-interest book**: The banks being acquired are heavily dependent on interest income. Diversifying the income stream could increase profitability.
- **Use of alternative channels**: Equity prides itself in its increased use of alternative channels as it reduces transactions in the branches. This could help the bank reduce costs.
- **Possibility of lowering cost through agency banking**: ATML recently launched agency banking in its subsidiaries. Equity bank could leverage on this to decrease costs.

The key disadvantage of this deal is investor dilution and the possible a reduction in the profitability ratios in the short-term due to the purchase of less profitable entities.

Date: 2nd May 2019

ROE: 21.1%

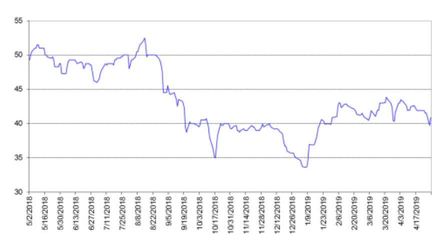
ROA: 3.6%

Dividend yield: 4.9%

52 week range: KES 33.40 to KES 42.85

FY18 EPS: KES 5.25

Latest Results: FY2018



Analyst

Sarah Wanga

+254711047105

wangas@aibcapital.com

The success of the acquisition will depend on the strategy that EGH adopts in the various country. The agency model has worked in Kenya and a number of its subsidiaries while in others (e.g. DRC), the bank focused on growing its topline. In DRC Equity decided to reduce its reliance on non-interest income (87% of total income in 2015 to 35% in 2018) and shifted to the more profitable interest income. The bank has slowly decreased its costs to a CTI ratio of 69.7% in 2018 from 80.3% in 2017.

Rwanda

Equity Bank Rwanda has performed relatively well over the years. ROE currently stands at 20.1% while the cost to income ratio has declined over the years to 50.1%. The controlling stake in ATML Rwanda is likely to be positive for the bank.

Banque Populaire du Rwanda is the second largest bank in terms of assets and has the largest branch and ATM network in Rwanda.

Opportunities:

Opportunities for increased profitability lie in scaling down the branch network and focusing on agency banking. This is expected to lower the bank's operating costs. The increased efficiency will help drive profitability. However, the profitability of Equity Bank Rwanda (was Equity's second most profitable subsidiary) is likely to decrease in the short-term but the country could be a key growth driver going forward.

Tanzania

Equity already has a subsidiary in Tanzania and the acquisition should help expand operations in the country. In 2018, Equity Tanzania made a loss as the company's cost to income ratio increased to 79%. Asset quality was also a source of concern, the NPL ratio stood at 25.7%.

Given the challenges the bank is currently facing in the country, we are concerned about the increased investment, especially since African Banking Corporation Tanzania is also struggling.

There seem to be limited opportunities for growth in Tanzania due to the unfavourable operating environment in the country.

Mozambique

The macro-economic conditions in the country are currently unfavourable. The country's growth has slowed from 7% between 2010 to 2015 to 3.3% in 2018. Mozambique is currently in debt distress and has defaulted on its external obligations.

This market provides an opportunity for Equity to increase its margins. However, the deterioration in asset quality might outweigh the benefits from margin expansion.

Benefit for ATML

- **Sale of its less profitable ventures**: ATML has retained its shareholding in Botswana, Zimbabwe and Nigeria. Zimbabwe is its largest profit contributor by country. The sale of the East African banks is likely to improve ATML's ROE which stood at 5.6% in 2017, partly weighed down by East Africa (ROE of 1.8%).
- **Improved profitability for the group:** The 6% shareholding in Equity Group is likely to improve ATML's numbers as it gives ATML a share in a more profitable company. Equity has managed to maintain attractive an ROE of above 20%. This could significantly benefit ATML whose ROE stands at 5.6%. For this reason, we believe that ATML will hold onto its stake in Equity and could even seek to increase its shareholding.

The latest breakdown of regional contribution for ATML are for FY2017.

KES Mn	South Africa	East Africa	West Africa
Interest income	20,265.65	6,480.36	
Interest expense	(8,860.33)	(2,626.71)	
Net interest income	11,405.32	3,853.66	
Non-interest income	6,945.67	1,613.88	
Operating expenses	(15,831.75)	(4,183.42)	
PBT	1,234.02	320.57	3,878.40
PAT	856.78	296.33	3,878.40
Loans	104,791.64	28,958.42	
Assets	202,011.11	50,802.60	44,716.54
Deposits	152,016.21	37,608.97	
Liabilities	189,391.56	42,648.97	

CONTACTS:

Research Desk
Sarah Wanga
wangas@aibcapital.com
(+254) 711047105

Victor Koech
koechv@aibcapital.com
(+254) 711047133

Equities Dealing
Bernard Kung'u
kungub@aibcapital.com
(+254) 711047108

Benard Gichuru
gichurub@aibcapital.com
(+254) 711047111

Brian Tanui
tanuib@aibcapital.com
(+254) 711047124

Bond Dealing
Crispus Otieno
otienoc@aibcapital.com
(+254) 711047113

Titus Marenye
marenyet@aibcapital.com
(+254) 711047118