

## Behind the Optics of the Arab Investment Bank Potential Acquisition

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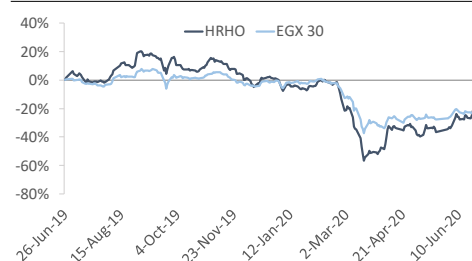
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### Stock data

Ticker	HRHO
ADTV 6-month (EGP000)	17,940
52-week low/high	6.54 - 20.60
Market cap (EGPmn)	10,661
No. of shares out. (mn)	769
Free float	65%
ytd stock return	-18.3%
P/B	0.8x
P/E	9.7x

### Stock price performance (last 12 months)



\* Last price as of 24 June 2020.

Source: Bloomberg.

- An intent for acquisition:** EFG Hermes Holding [HRHO] and The Sovereign Fund of Egypt (TSFE) announced earlier yesterday their potential acquisition of 76% of state-owned Arab Investment Bank (aiBank). Completed, the transaction would leave HRHO and TSFE with respective ownership of 51% and 25% in the bank, while the remainder will be split between the existing shareholders pro rata. Both HRHO and TSFE received an approval to conduct their due diligence (possibly taking three months to complete) on the bank from the Central Bank of Egypt (CBE) which would also be needed to bless the final step of the acquisition.
- What's in it for HRHO?** In our view, we see this potential acquisition providing synergies that would lift HRHO's exposure and ability to expand geographically, with aiBank's existing c.30 branches spanning several governorates around Egypt. The move would also enable HRHO to have wider banking access to serve its NBFI activity which the full-fledged financial services firm has been rapidly expanding in recently. This is not the first time that HRHO taps commercial banking; it had previously penetrated Lebanon by investing in Credit Libanais, the remaining stake of which it just wrote off in Q1 2020 after disturbance and uncertainty in Lebanon hit its economy.
- Would synergies justify the acquisition price?** aiBank's financials for 2017, the latest detailed figures available, suggest an ROE of 10.6% versus the banking sector's median of 28% in the same year and a current sector median of 24% (as per EGX-listed banks). aiBank announced in May this year that it was in the process of hiking up its capital by EGP800mn, a step that would raise the bank's paid-in capital to EGP1.8bn. Having targeted an annual growth rate of 25% per annum in 2018 onwards, aiBank should have generated some EGP222mn in net income in 2019, as per our estimates. The question is then whether the potential synergies will be large enough to justify the acquisition price.
- But at what price?** We assumed that HRHO and TSFE could pay 1x aiBank's book equity, a slight premium to Egyptian banks' median P/B of 0.9x, which we believe is not justified by the bank's below-market ROE as mentioned above but implicitly include an acquisition premium. Additionally, under the CBE's requirements, aiBank would be required to increase its paid-in capital to EGP5bn by 2022, which should stand today at EGP1.8bn, following the government's recently-approved EGP800mn capital increase.

Thursday, 25 June 2020 / 1:00 pm CLT

Egypt / Non-Banking Financials

Equity Note / Reason for note: Potential acquisition of aiBank

- Scenario analysis:** To assess the impact of this potential deal on HRHO's financials, we constructed two scenarios (please refer to [Page 3](#)), but we think the second is more likely:
  - Scenario 1:** aiBank's capital is increased by 100% with no stake sale by the existing shareholders (topped by National Investment Bank). Under this scenario, the acquisition would leave aiBank's current shareholders maintaining their EGP1.8bn portion of the bank's equity capital and HRHO and TSFE injecting EGP5.7bn for their stakes to reach the 76% target, thus taking the equity capital to EGP7.5bn.
  - Scenario 2:** A partial secondary sale is made by aiBank's existing shareholders in addition to a capital increase. Under this scenario, we assume that the current shareholders would be selling a third of their current holdings in the bank. Afterwards, the takeover would lead the new shareholders, HRHO and TSFE, to inject EGP3.2bn, thus raising aiBank's equity capital to EGP5bn, as required by the CBE.
- Conclusion:** Based on HRHO's current LTM valuation multiples (P/B of 0.8x and P/E of 9.7x), we examined the medium-term impact (i.e. by end of 2021) of the potential acquisition which we assumed to be concluded by end of 2020, then we applied HRHO's current LTM multiples to HRHO's then-consolidated figures by end of 2021. This exercise resulted in a PT by end of 2021 of EGP17 (an upside potential of 23%). We note that this exercise does not take into account any synergies that could boost HRHO's performance nor a correction to current mispricing.

#### Sensitivity analysis for HRHO's stock valuation

		P/Bx			
P/Ex		0.6x	0.8x	1.0x	
	10.7x	15.3	17.9	19.5	EGP/share (end of 2021)
	9.7x	14.5	17.0	18.7	
	8.7x	13.7	16.2	17.9	

		P/Bx			
P/Ex		0.6x	0.8x	1.0x	
	10.7x	11%	29%	41%	Upside potential
	9.7x	5%	23%	35%	
	8.7x	-1%	17%	29%	

Source: Prime Research.

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## Our analysis of the impact on HRHO & aiBank financial statements (financial figures are in EGPmn, unless otherwise noted)

aiBank's shareholder structure			
	Current	Scenario 1 100% capital increase, no secondary sale	Scenario 2 Reaching minimum capital of EGP5bn (EGP3.2bn capital increase, EGP600mn secondary sale)
%			
<b>Existing shareholders</b>	<b>100.00%</b>	<b>24.00%</b>	<b>24.00%</b>
National Investment Bank (NIB)	91.42%	21.94%	21.94%
Others	8.58%	2.06%	2.06%
<b>New shareholders</b>	<b>0.00%</b>	<b>76.00%</b>	<b>76.00%</b>
EFG Hermes Holding [HRHO]	0.00%	51.00%	51.00%
The Sovereign Fund of Egypt (TSFE)	0.00%	25.00%	25.00%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

				Capital incr.	Secondary sale
<b>EGPmn</b>					
<b>Existing shareholders</b>	<b>1,800</b>	<b>1,800</b>	<b>1,200</b>		<b>(600)</b>
National Investment Bank (NIB)	1,646	1,646	1,097		(549)
Others	154	154	103		(51)
<b>New shareholders</b>	<b>-</b>	<b>5,700</b>	<b>3,800</b>	<b>3,200</b>	<b>600</b>
EFG Hermes Holding [HRHO]	-	3,825	2,550	2,147	403
The Sovereign Fund of Egypt (TSFE)	-	1,875	1,250	1,053	197
<b>Total</b>	<b>1,800</b>	<b>7,500</b>	<b>5,000</b>	<b>3,200</b>	<b>-</b>

Financial KPIs for HRHO and aiBank (historical and post transaction)				
EFG Hermes Holding [HRHO]	LTM		Scenario 1	Scenario 2
Cash & CE	7,364		3,539	4,814
Total assets	39,486			
Total liabilities	26,446			
<b>Total equity</b>	<b>13,040</b>		<b>22,548</b>	<b>19,798</b>
Minorities	339		4,998	3,650
<b>Equity, net of minorities</b>	<b>12,701</b>		<b>17,550</b>	<b>16,148</b>
<b>Net income before minorities</b>	<b>1,114</b>		<b>2,008</b>	<b>1,758</b>
ROE (before minorities)	8.5%		8.90%	8.88%
<b>Net income after minorities</b>	<b>1,095</b>		<b>1,360</b>	<b>1,296</b>
ROE (after minorities)	8.6%			

aiBank	Business as usual			Post HRHO+TSFE acquisition	
	2019	2020	2021	2021	
				Scenario 1	Scenario 2
Estimated equity	1,867				
Estimated equity post recent capital increase	<b>2,667</b>	2,914	3,238		
<b>Implied post money value</b>				<b>9,508</b>	<b>6,758</b>
Estimated net income	222	247	324	894	644
% growth		11%	31%		
Estimated ROE	11.9%	8.5%	10.0%	9.4%	9.5%
<b>Estimated equity post HRHO+TSFE capital injection</b>				<b>9,508</b>	<b>6,758</b>

Implied valuation of aiBank			
P/BVx	1.0x	0.9x	0.8x
P/Ex	12.0x	10.8x	8.2x

Impact on HRHO					
	NOS (mn)	Price/sh.	EGPmn	P/BVx	P/Ex
HRHO (price as of 24 June 2020)	769	13.87	10,666	0.8x	9.7x
Based on Scenario 2	LTM	New (2021)		New (2021)	Upside in 12M
EGPmn					
HRHO's equity, net of minorities	12,701	16,148	Based on P/BV	13,560	
HRHO's earnings	1,095	1,296	Based on P/E	12,622	
ROE	8.6%	8.0%			

EGP/share (end of 2021) assuming no re-rating of current multiples implied by HRHO's stock price	Based on P/BV	17.6	27%
	Based on P/E	16.4	18%
	Average	17.0	23%

Source: Companies' reports, Prime Research.

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