EQUITY GROUP – Q1'2023

19th May, 2023

Below is a summary of Equity Group Q1'2023 performance:

Balance Sheet	Q1'2022	Q1'2023	y/y change
Government Securities	233.9	216.0	(7.7%)
Net Loans and Advances	623.6	756.3	21.3%
Total Assets	**1269.5**	**1537.7**	**21.1%**
Customer Deposits	900.9	1111.2	23.3%
Deposits per branch	2.7	3.1	17.4%
Total Liabilities	**1095.3**	**1347.0**	**23.0%**
Shareholders' Funds	**167.2**	**183.8**	**9.9%**

Key Ratios	Q1'2022	Q1'2023	% point change
Loan to Deposit Ratio	69.2%	68.1%	(1.1%)
Return on average equity	28.7%	26.8%	(1.9%)
Return on average assets	3.7%	3.4%	(0.3%)

Income Statement	Q1'2022	Q1'2023	y/y change
Net Interest Income	19.4	21.7	12.1%
Net non-Interest Income	11.9	18.4	54.3%
Total Operating income	**31.3**	**40.1**	**28.2%**
Loan Loss provision	(1.8)	(3.5)	92.5%
Total Operating expenses	(16.0)	(23.2)	45.1%
Profit before tax	15.3	16.9	10.5%
Profit after tax	**11.9**	**12.8**	**7.9%**
Core EPS	**3.1**	**3.4**	**7.9%**

Income Statement Ratios	Q1'2022	Q1'2023	y/y change
Yield from interest-earning assets	2.4%	2.6%	0.2%
Cost of funding	2.8%	3.2%	0.4%
Cost of risk	5.8%	8.7%	2.9%
Net Interest Margin	7.2%	7.4%	0.2%
Net Interest Income as % of operating income	61.9%	54.1%	(7.8%)
Non-Funded Income as a % of operating income	38.1%	45.9%	7.8%
Cost to Income Ratio	51.1%	57.9%	6.8%
CIR without LLP	45.3%	49.2%	3.9%
Cost to Assets	1.2%	1.4%	0.2%

Capital Adequacy Ratios	Q1'2022	Q1'2023	% points change
Core Capital/Total Liabilities	16.3%	17.7%	1.4%
Minimum Statutory ratio	8.0%	8.0%	
Excess	**8.3%**	**9.7%**	**1.4%**
Core Capital/Total Risk Weighted Assets	13.9%	15.5%	1.6%
Minimum Statutory ratio	10.5%	10.5%	
Excess	**3.4%**	**5.0%**	**1.6%**
Total Capital/Total Risk Weighted Assets	18.7%	19.8%	1.1%
Minimum Statutory ratio	14.5%	14.5%	
Excess	**4.2%**	**5.3%**	**1.1%**
Liquidity Ratio	56.9%	51.5%	(5.4%)
Minimum Statutory ratio	20.0%	20.0%	
Excess	**36.9%**	**31.5%**	**(5.4%)**
Adjusted core capital/ total deposit liabilities	16.3%	17.7%	1.4%
Adjusted core capital/ total risk weighted assets	13.9%	15.5%	1.6%

Adjusted total capital/ total risk weighted assets	18.7%	19.8%	1.1%

Income Statement

- Core earnings per share rose by 7.9% to Kshs 3.4, from Kshs 3.1 in Q1’2022, lower than our projected growth to Kshs 3.1 in Q1’2023, with the variance stemming from the lenders’ 54.3% growth in Non-Funded Income to Kshs 18.4 bn, from Kshs 11.9 bn in Q1’2022 which is in contrast to our projection of a 7.1% increase to Kshs 12.8 bn. The lender’s overall performance was driven by the 28.2% growth in total operating income to Kshs 40.1 bn, from Kshs 31.3 bn in Q1’2022. However, the performance was weighed down by a 45.1% growth in total operating expenses to Kshs 23.2 bn, from Kshs 16.0 bn in Q1’2022,
- The 28.2% growth in total operating income was mainly driven by a 12.1% increase in Net Interest Income to Kshs 21.7 bn, from Kshs 19.4 bn in Q1’2022, coupled with a 54.3% growth in Non-Funded Income to Kshs 18.4 bn, from Kshs 11.9 bn in Q1’2022,
- Interest income grew by 21.6% to Kshs 32.4 bn, from Kshs 26.7 bn in Q1’2022, mainly driven by a 21.0% growth in interest income from loans and advances to Kshs 20.7 bn, from Kshs 17.1 bn in Q1’2022. Additionally, Interest income from government securities grew by 14.4% to Kshs 10.7 bn from Kshs 9.3 bn in Q1’2022. As such, the Yield on Interest-Earning Assets (YIEA) increased to 2.6%, from 2.4% recorded in Q1’2022, mainly attributable to the faster 21.6% growth in interest income compared to a 17.8% increase in average interest earning assets to Kshs 1,199.7 bn, from Kshs 1,018.7 bn in Q1’2022,
- Interest expenses rose by 46.9% to Kshs 10.8 bn, from Kshs 7.3 bn in Q1’2022, driven by 49.5% increase in interest expense on customer deposits to Kshs 7.4 bn, from Kshs 5.0 bn in Q1’2022, coupled with a 62.7% increase in interest expense from deposits and placements to Kshs 1.0 bn in Q1’2023, from Kshs 0.6 bn recorded in Q1’2022. Consequently, Cost of funds (COF) increased by 0.4% points to 3.2%, from 2.8% recorded in Q1’2022, owing to the 35.6% increase in Trailing interest expense to Kshs 37.1 bn, from Kshs 27.3 bn recorded in Q1’2022, faster than a 20.3% increase in average interest bearing liabilities to Kshs 1,159.1 bn from Kshs 963.7 bn in Q1’2022.Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) increased by 0.2% points to 7.4% from 7.2% in Q1’2022, attributable to a 20.4% increase in trailing net interest income to Kshs 88.3 bn, from Kshs 73.3 bn recorded in Q1’2022 which outpaced the 17.8% growth in average interest earning assets,
- Non-Funded Income (NFI) increased by 54.3% to Kshs 18.4 bn, from Kshs 11.9 bn in Q1’2022, mainly driven by a 152.3% increase in the foreign exchange trading income to Kshs 5.2 bn, from Kshs 2.0 bn in Q1’2022, highlighting the group’s increased foreign exchange margins. Other fees and commission income increased by 50.9% to Kshs 9.1 bn from Kshs 6.0 bn, as such, total fees and commissions increased by 39.2% to Kshs 11.1 bn, from Kshs 8.0 bn in Q1’2022. The revenue mix shifted to 54:46 from 62:38 for the funded to Non-funded income owing to the 12.2% growth in Funded Income slower than the 54.3% growth in Non-Funded Income,
- Total operating expenses increased by 45.1% to Kshs 23.2 bn, from Kshs 16.0 bn in Q1’2022, driven by 92.5% increase in loan loss provisions to Kshs 3.5 bn, from Kshs 1.8 bn recorded in Q1’2022, coupled with a 42.3% increase in other expenses to Kshs 13.1 bn from Kshs 9.2 bn in Q1’2022. The increase in provisioning is partly attributable to rising credit risk as a result deteriorioted economic environment as evidenced by the average Purchasing Managers Index (PMI) of 49.3 in Q1’2023, down from an average of 50.3 in Q1’2022,
- Cost to Income Ratio (CIR) increased to 57.9%, from 51.1% in Q1’2022, owing to the 45.1% increase in total operating expenses, which outpaced the 28.2% increase in total operating income. Similarly, CIR without LLP increased by 3.9% points to 49.2% from 45.3% recorded in Q1’2022 an indication of decreased efficiency, and,
- Profit before tax increased by 10.5% to Kshs 16.9 bn, from Kshs 15.3 bn in Q1’2022, with effective tax rate increasing to 24.2% in Q1’2023, from 22.4% in Q1’2022, leading to an 7.9% increase in profit after tax to Kshs 12.8 bn in Q1’2023, from Kshs 11.9 bn in Q1’2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 21.1% to Kshs 1,537.7 bn, from Kshs 1,269.5 bn in Q1’2022, driven by a 21.3% loan book expansion to Kshs 756.3 bn, from Kshs 623.6 bn in Q1’2022, coupled with a 52.1% increase in placemenets due from banking institutions to Kshs 143.4 bn, from Kshs 94.3 bn in Q1’2022. However, the expansion in the balance sheet was weighed down by a 7.7% decreae in investment in government securities to Kshs 216.0 bn, from Kshs 233.9 bn in Q1’2022,
- Total liabilities increased by 23.0% to Kshs 1,347.0 bn, from Kshs 1,095.3 bn in Q1’2022, driven by a 23.3% growth in customer deposits to Kshs 1,111.2 bn, from Kshs 900.9 bn in Q1’2022, coupled with a 96.0% increase in placements to 44.9 bn, from Kshs 22.9 bn recorded in Q1’2022. With 354 branches countrywide compared to 337 branches in Q1’2022, deposits per branch increased by 17.4% to Kshs 3.1 bn, from Kshs 2.7 bn in Q1’2022,
- The faster 23.3% growth in deposits as compared to the 21.3% growth in loans led to a decrease in the loan to deposits ratio to 68.1%, from 69.2% in Q1’2022,
- The group’s Asset Quality deteriorated, with Gross NPL ratio increasing to 10.0% in Q1’2023, from 9.0% in Q1’2022, attributable to 35.2% increase in Gross non-performing loans to Kshs 80.3 bn, from Kshs 59.4 bn in Q1’2022, which outpaced the 21.6% increase in gross loans to Kshs 806.1 bn, from Kshs 662.8 bn recorded in Q1’2022,
- General Provisions (LLP) increased by 21.3% to Kshs 34.4 bn in Q1’2023, from Kshs 28.3 bn in Q1’2022. The NPL coverage decreased to 62.0% in Q1’2023, from 66.0% in Q1’2022, attributable to the 21.3% increase in provisions coupled with 41.9% increase in interest in suspense to Kshs 15.4 bn from 10.9 bn in Q1’2022, which offset the 35.2% increase in Gross Non-Performing loans,
- Shareholders’ funds increased by 9.9% to Kshs 183.8 bn in Q1’2023, from Kshs 167.2 bn in Q1’2022, supported by a 18.4% increase in retained earnings to Kshs 186.8 bn, from Kshs 157.8 bn in Q1’2022,
- Equity Group remained capitalized with a core capital to risk-weighted assets ratio of 15.5%, 5.0% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 19.8%, exceeding the statutory requirement of 14.5% by 5.3% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 15.5%, while total capital to risk-weighted assets came in at 19.8%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.4%, and a Return on Average Equity (ROaE) of 26.8%.

Key Take-Outs:

1. **Earnings growth -** Core earnings per share (EPS) grew by 7.9% to Kshs 3.4, from Kshs 3.1 in Q1’2022. The strong growth was mainly driven by the 28.2% growth in total operating income to Kshs 40.1 bn from Kshs 31.3 bn in Q1’2022, However, the performance was weighed down by a 45.1% growth in total operating expenses to Kshs 23.2 bn, from Kshs 16.0 bn in Q1’2022,
2. **Increased Provisioning -** On the back of high credit risk occassione by the deteriorated business environment, the bank increased its provisions holdings to cover for the anticipated losses in the future, with its provisions increasing by 92.5% to Kshs 3.5 bn from Kshs 1.8 bn recorded in Q1’2022. The high credit risk is further evidenced by the 35.2% increase in bank’s gross non-performing loans to Kshs 80.3 bn in Q1’2023, from Kshs 59.4 bn recorded in Q1’2022, and,
3. **Revenue Diversification –** Non-Funded Income (NFI) increased by 54.3% to Kshs 18.4 bn, from Kshs 11.9 bn in Q1’2022, mainly driven by a 152.3% increase in the foreign exchange trading income to Kshs 5.2 bn, from Kshs 2.0 bn in Q1’2022, highlighting increased revenue diversification.

Going forward, the factors that would drive the bank’s growth would be:

- **Digital transformation**. We expect innovation and digitization continue to enhance high value transaction. In FY’2022, the bank disclosed that 99.0% of its transactions were done on alternative channels, with mobile and internet transactions taking up 79.2% of all transactions, and agency banking contributing 6.2% of all transactions. Additionally, value of transactions had continued to increase with digital banking, branches and diaspora remittances contributing 48.0%, 26.6% and 4.9%, respectively.

Valuation Summary

- We are of the view that Equity Group is a “buy” with a target price of Kshs 56.3 representing an upside of 57.1%, from the current price of 38.4 as of 19th May 2023, inclusive of a dividend yield of 10.4%.
- Equity Group is currently trading at a P/TBV of 0.8x and a P/E of 3.1x vs an industry average of 0.7x and 3.4 respectively.