Equity Group Holdings Plc – Q3’2021

12th November, 2021

Below is a summary of Equity Group Holdings Plc Q3’2021 performance:

Balance Sheet Items (Kshs bn)	Q3'2020	Q3'2021	y/y change
Government Securities	185.3	233.2	25.8%
Net Loans and Advances	453.9	559.0	23.2%
Total Assets	**933.9**	**1184.3**	**26.8%**
Customer Deposits	691.0	875.1	26.6%
Total Liabilities	796.3	1020.9	28.2%
Shareholders’ Funds	**130.7**	**156.3**	**19.6%**

Balance Sheet Ratios	Q3'2020	Q3'2021	% points y/y change
Loan to Deposit Ratio	65.7%	63.9%	(1.8%)
Return on average equity	16.9%	22.2%	5.4%
Return on average assets	2.5%	3.0%	0.5%

Income Statement (Kshs bn)	Q3'2020	Q3'2021	y/y change
Net Interest Income	39.3	48.5	23.3%
Net non-Interest Income	24.8	32.0	28.8%
Total Operating income	**64.1**	**80.5**	**25.5%**
Loan Loss provision	(14.8)	(5.1)	(65.2%)
Total Operating expenses	(45.3)	(43.8)	(3.2%)
Profit before tax	19.8	36.6	85.3%
Profit after tax	**15.0**	**26.9**	**78.6%**
Core EPS	**4.0**	**7.1**	**78.6%**

Income Statement Ratios	Q3'2020	Q3'2021	% points y/y change
Yield from interest-earning assets	10.1%	9.6%	(0.5%)
Cost of funding	2.6%	2.8%	0.2%
Cost of risk	23.0%	6.4%	(16.6%)
Net Interest Margin	7.6%	7.0%	(0.7%)
Net Interest Income as % of operating income	61.3%	60.3%	(1.0%)
Non-Funded Income as a % of operating income	38.7%	39.7%	1.0%
Cost to Income Ratio	70.6%	54.5%	(16.1%)
CIR without LLP	47.6%	48.1%	0.5%
Cost to Assets	3.8%	3.7%	(0.1%)

Capital Adequacy Ratios	Q3'2020	Q3'2021
Core Capital/Total Liabilities	16.1%	15.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**8.1%**	**7.3%**
Core Capital/Total Risk Weighted Assets	14.5%	13.5%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.0%**	**3.0%**
Total Capital/Total Risk Weighted Assets	17.5%	16.8%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.0%**	**2.3%**
Liquidity Ratio	55.7%	59.5%
Minimum Statutory ratio	20.0%	20.0%

Excess	**35.7%**	**39.5%**
Adjusted core capital/ total deposit liabilities	16.4%	15.3%
Adjusted core capital/ total risk weighted assets	14.8%	13.5%
Adjusted total capital/ total risk weighted assets	17.7%	16.8%

Key Highlights

- In October 2021, Equity Group announced that it had received two guarantee facilities totaling Kshs 5.0 bn (€39.0 mn) from Proparco for onward lending to Micro Small and Medium-sized Enterprises (MSMEs) and Women Entrepreneurs. The Group has collectively received approximately Kshs 38.0 bn to boost credit flows and liquidity to MSMEs since the pandemic began after signing three other loans; USD 50.0 mn (Kshs 5.5 bn) with IFC in September 2020, USD 100.0 mn (Kshs 11.0 bn) with Proparco in October 2020 and Kshs €125.0 mn (Kshs 16.5 bn) in March 2021.

Income Statement

- Core earnings per share increased by 78.6% to Kshs 7.1 in Q3’2021, from Kshs 4.0 recorded in Q3’2020, higher than our projections of a 65.7% increase to Kshs 6.6. The performance was driven by a 25.5% growth in total operating income to Kshs 80.5 bn, from Kshs 64.1 bn in Q3’2020, coupled with a 3.2% decline in total operating expenses to Kshs 43.8 bn, from Kshs 45.3 bn in Q3’2020. The variance in core earnings per share growth against our expectations was due to the Non-Funded Income increasing by 28.8% to Kshs 32.0 bn in Q3’2021, from Kshs 24.8 bn in Q3’2020, against our expectation of a 13.3% growth in Q3’2021 to Kshs 28.1 bn,
- Total Operating Income rose by 25.5% to Kshs 80.5 bn, from Kshs 64.1 bn recorded in Q3’2020 driven by a 28.8% increase in Non-Funded Income (NFI) to Kshs 32.0 bn, from Kshs 24.8 bn in Q3’2020, coupled with a 23.3% increase in Net Interest Income (NII) to Kshs 48.5 bn, from Kshs 39.3 bn in Q3’2020,
- Interest income increased by 28.7% to Kshs 67.0 bn, from Kshs 52.1 bn in Q3’2020 driven by a 34.2% increase in interest income from government securities to Kshs 20.7 bn, from Kshs 15.4 bn in Q3’2020, coupled with a 24.4% increase in interest income on loans and advances to Kshs 44.8 bn, from Kshs 36.0 bn recorded in Q3’2020. The Yield on Interest-Earning Assets, however, declined by 0.5% points to 9.6%, from 10.1% in Q3’2020, as the average interest-earning assets grew faster by 35.2% to Kshs 919.8 bn, from Kshs 680.3 bn in Q3’2020 compared to the 28.5% increase in trailing interest income. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense rose by 45.0% to Kshs 18.5 bn, from Kshs 12.8 bn in Q3’2020, following a 181.4% increase in interest expense on deposits and placements to Kshs 1.5 bn, from Kshs 0.5 bn in Q3’2020, coupled with a 33.8% increase in interest expense on customer deposits to Kshs 12.8 bn, from Kshs 9.6 bn in Q3’2020. Cost of funds rose by 0.2% points to 2.8%, from 2.6% in Q3’2020, owing to the faster 43.3% growth in trailing interest expense, which outpaced the 33.3% growth in the average interest-bearing liabilities. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) however declined to 7.0%, from 7.6% in Q3’2020, attributable to the 35.2% growth in average interest-earning assets, which outpaced the 23.7% growth of trailing Net Interest Income (NII),
- Non-Funded Income (NFI) rose by 28.8% to Kshs 32.0 bn, from Kshs 24.8 bn in Q3’2020. The increase was mainly driven by a 30.5% increase in Fees and commissions on loans and advances to Kshs 5.7 bn, from Kshs 4.4 bn in Q3’2020, coupled with a 41.0% growth in Foreign Exchange Trading income to Kshs 5.6 bn, from Kshs 4.0 bn in Q3’2020. Equity Group’s total fees and commission increased by 34.2% to Kshs 20.8 bn, from Kshs 15.5 bn in Q3’2020, due to the lifting of the waiver of charges between mobile money wallets and bank accounts in the Kenyan subsidiary. Notably, the revenue mix shifted to 60:40

from 61:39, funded to non-funded income, recorded in Q3'2020, owing to the faster 28.8% increase in non-funded income compared to the 23.3% growth in net funded income,

- Total operating expenses declined by 3.2% to Kshs 43.8 bn in Q3'2021, from Kshs 45.3 bn recorded in Q3'2020, mainly due to a 65.2% decline in Loans Loss Provision to Kshs 5.1 bn in Q3'2021, from Kshs 14.8 bn recorded in Q3'2020. The reduced provision level was due to the economic recovery witnessed in 2021 so far and as evidenced by the 10.1% growth in Kenya's GDP recorded in Q2'2021. The lifting of many Covid-related restrictions and the subsequent economic recovery has alleviated many of the uncertainties surrounding the business environment and bank borrowers' ability to repay their loans hence the reduced provisions. On the other hand, Staff Costs grew by 24.9% to Kshs 13.5 bn in Q3'2021 from Kshs 10.8 bn recorded in Q3'2020,
- As a result of the 65.2% decrease in Loans Loss Provisions (LLP), Cost to Income Ratio (CIR) with LLP improved by 16.1% points to 54.5%, from 70.6% in Q3'2020. Without LLP, however, the Cost to Income ratio deteriorated by 0.5% points to 48.1%, from 47.6% in Q3'2020, an indication of reduced efficiency levels in the Banks,
- Profit before tax increased by 85.3% to Kshs 36.6 bn, from Kshs 19.8 bn in Q3'2020. Profit after tax increased by 78.6% to Kshs 26.9 bn in Q3'2021, from Kshs 15.0 bn recorded in Q3'2020 with the effective tax rate increasing to 26.6% from 23.9% in Q3'2020.

Balance Sheet

- The balance sheet recorded an expansion as Total Assets increased by 26.8% to Kshs 1.2 tn in Q3'2021, from Kshs 0.9 tn recorded in Q3'2020. This growth was largely driven by the 23.2% growth of the loan book to Kshs 559.0 bn, from Kshs 453.9 bn recorded in Q3'2020, coupled with a 25.8% growth in Government securities to Kshs 233.2 bn in Q3'2021, from Kshs 185.3 bn in Q3'2020. The remarkable expansion in the balance sheet is also partly attributable to the 66.5% stake acquisition of Banque Commerciale Du Congo (BCDC) in August 2020. BCDC contributed Kshs 328.3 bn worth of assets in Q3'2021 to the Group,
- Total liabilities rose by 28.2% to Kshs 1.0 tn, from Kshs 0.8 tn in Q3'2020, driven by a 26.6% increase in customer deposits to Kshs 875.1 bn, from Kshs 691.0 bn in Q3'2020. Key to note, the strong growth in customer deposits is mainly attributable to the acquisition of BCDC, with the subsidiary contributing Kshs 304.6 bn to the total deposits. Deposits per branch increased by 25.9% to Kshs 2.6 bn, from Kshs 2.1 bn in Q3'2020, with the number of branches increasing by 2 to 337 branches in Q3'2021, from 335 in Q3'2020, with Equity Bank Rwanda and Equity Bank Uganda contributing 1 additional branch each,
- The faster 26.6% growth in customer deposits as compared to the 23.2% growth in loans, led to a decline in the Loans to deposit ratio to 63.9% from 65.7% in Q3'2020,
- Gross Non-Performing Loans (NPLs) increased by 8.5% to Kshs 56.2 bn in Q3'2021, from Kshs 51.8 bn recorded in Q3'2020. The group's asset quality improved, with the NPL ratio declining to 9.5% in Q3'2021, from 10.8% recorded in Q3'2020, attributable to the faster 23.4% growth in gross loans, compared to an 8.5% growth in Gross Non-Performing Loans (NPLs). The main sectors that contributed to the Non-Performing Loans were MSMEs and Agriculture, which contributed 30.8% and 6.5%, respectively. The group's Tanzanian subsidiary recorded the highest NPL ratio, coming in at 25.6% in Q3'2021, with Equity Bank Kenya recording an NPL ratio of 9.0% in Q3'2021,
- With the general Loan Loss Provisions increasing by 28.1% to Kshs 27.0 bn, from Kshs 21.1 bn in Q3'2020, higher than the 8.5% rise in the Gross Non-Performing Loans, the NPL coverage improved to 60.6%, from 52.0% in Q3'2020, an indication of sufficient provisioning,
- Shareholders' funds grew by 19.6% to Kshs 156.3 bn in Q3'2021, from Kshs 130.7 bn in Q3'2020, mainly supported by a 27.4% growth in retained earnings to Kshs 145.2 bn, from Kshs 114.0 bn in Q3'2020,
- Equity Group is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 13.5%, 3.0% points above the minimum statutory requirement. In addition, the total capital to risk-weighted

assets ratio was 16.8%, exceeding the minimum statutory requirement by 2.3% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 13.5% while total capital to risk-weighted assets came in at 16.8%, and,

- The bank currently has a Return on Average Assets (ROaA) of 3.1%, and a Return on Average Equity (ROaE) of 22.2%.

Key Take-Outs:

1. The Group’s geographical diversification strategy has continued to emerge as a net positive, with the bank’s various subsidiaries in Uganda, DRC, Rwanda, Tanzania, and South Sudan cumulatively contributing 23.0% to the bank’s total profitability and 40.0% to the group’s total asset base. However, given the high NPL levels in the group’s Tanzania subsidiary of 25.6%, the group will need to improve its credit assessment in the country to bring down the high NPL ratio. Cumulatively, the group’s subsidiaries, excluding Equity Bank Kenya Ltd, recorded an 97.6% growth in their Profit after Tax (PAT) to Kshs 21.0 bn, from Kshs 10.6 bn in Q3’2020, with the Tanzanian subsidiary recording a y/y growth of 189.0% to a profit of Kshs 0.2 bn in Q3’2021, from a recorded loss of Kshs 0.2 bn in Q3’2020, while the DRC subsidiary, Equity BCDC, recorded a growth of 125.0% in their Profit After Tax to Kshs 2.2 bn in Q3’2021 from Kshs 0.3 bn in Q3’2020. Total assets in the bank’s regional subsidiaries, excluding Equity Bank Kenya Ltd, grew by 14.6% to Kshs 384.0 bn in Q3’2021, from Kshs 335.0 bn in Q3’2020, largely driven by the 61.5% growth of the subsidiaries’ loan book to Kshs 105.1 bn, from Kshs 65.1 bn recorded in Q3’2020,
2. Equity Group’s recorded a remarkable increase in its balance sheet, as Total Assets increased by 26.8% to Kshs 1.2 tn, from Kshs 0.9 tn recorded in Q3’2020 as the business environment continues to improve. The increase is largely attributable to the 33.6% growth in assets held by the Kenyan subsidiary to Kshs 800.3 bn, from Kshs 598.9 bn, coupled with a 47.0% increase in assets held by the Group’s DRC subsidiary, Equity BCDC, which increased to Kshs 356.0 bn, from Kshs 154.0 bn in Q3’2020. The Group’s diversification into different markets will allow it to mitigate risks that are unique to Kenya such as the 2022 electioneering period as well as spread risks over economically well-placed economies,
3. Increased innovation and digitization have seen 96.9% of all transactions of the bank being done on alternative channels, with mobile and internet transactions taking up 86.9% of all transactions, and agency banking contributing 6.3% of all transactions. In terms of the value of transactions, digital banking, branches and diaspora remittances contributed 63.2%, 33.0% and 3.9%, respectively. This highlights the transformation of branches to handle high-value transactions. This transformation aids the bank by offering its ecosystem banking products to retail and SME clients, and,
4. The bank’s asset quality improved, as evidenced by the 1.3% points rise in the NPL ratio to 9.5% in Q3’2021, from 10.8% in Q3’2020. The main sectors that contributed to the Non-Performing Loans were MSMEs and Agriculture, which contributed 30.8% and 6.5%, respectively. The group’s Tanzanian subsidiary recorded the highest NPL ratio, coming in at 25.6% in Q3’2021, with Equity Bank Kenya recording an NPL ratio of 9.0% in Q3’2021. The subsidiaries, excluding Equity Bank Kenya Ltd, contributed 34.0% of the group's loan book. With the improvement in business conditions and expected economic recovery in Rwanda, Uganda, Kenya, Tanzania and DRC, we expect the group’s asset quality to improve in the medium term.

Going forward, we expect the bank’s growth to be driven by:

I. Channeled diversification is likely to further improve on efficiency with emphasis on alternative channels of transactions, as the bank rides on the digital revolution wave, thereby further improving the cost to income ratio by cost rationalization and revenue expansion. This will likely propel the bank’s prospects of achieving sustainable growth, as it replicates its successful business model across its various regional subsidiaries,

II. The bank’s operating model of enhancing balance sheet agility is likely to place the bank in a prime position to take advantage of any opportunities that may arise, such as attractive inorganic growth via acquisitions or fast lending with the repeal of the interest rate cap law. The bank’s balance sheet agility is seen with a liquidity ratio of 59.5%, loan deposit ratio of 63.9% and a core capital to risk-weighted asset ratio of 13.5%, and,

III. Continued expansion through acquisition of other banks in Kenya as well as in the region, including a consideration to purchase back a stake in Housing Finance (HF) Group. Equity Group previously owned 24.7% stake in HF Group but sold all their shares in 2014. The planned expansions will lead to further growth in the bank’s total assets and loan book which stand at Kshs 1.2 tn and Kshs 0.6 tn, respectively.

Valuation Summary

- We are of the view that Equity Group is an “***Accumulate***” with a target price of Kshs 62.4 representing an upside of 18.9%, from the current price of Kshs 52.5 as of 12th November 2021,
- Equity Group is currently trading at a P/TBV of 1.4x and a P/E of 6.2x vs an industry average of 1.0x and 6.2x, respectively.