Equity Group – Q3'2023

24th November, 2023

Below is a summary of Equity Group Q3'2023 performance:

Balance Sheet Items (Kshs bn)	Q3'2022	Q3'2023	y/y change
Government Securities	233.0	242.5	4.1%
Net Loans and Advances	673.9	845.9	25.5%
Total Assets	**1363.7**	**1691.2**	**24.0%**
Customer Deposits	1007.3	1207.7	19.9%
Deposits per branch	3.0	3.4	14.1%
Total Liabilities	1209.7	1497.9	23.8%
Shareholders' Funds	**147.5**	**183.9**	**24.7%**

Balance Sheet Ratios	Q3'2022	Q3'2023	% y/y change
Loan to Deposit Ratio	66.9%	70.0%	3.1%
Government securities to deposits ratio	23.1%	20.1%	(3.1%)
Return on average equity	31.3%	21.8%	(9.5%)
Return on average assets	3.7%	2.4%	(1.4%)

Income Statement (Kshs bn)	Q3'2022	Q3'2023	y/y change
Net Interest Income	59.8	72.6	21.3%
Net non-Interest Income	42.2	57.8	36.9%
Total Operating income	**102.1**	**130.4**	**27.8%**
Loan Loss provision	(9.7)	(19.0)	96.6%
Total Operating expenses	(57.7)	(84.5)	46.3%
Profit before tax	44.3	45.9	3.6%
Profit after tax	**34.4**	**36.2**	**5.3%**
Core EPS (Kshs)	**9.1**	**9.6**	**5.3%**

Income Statement Ratios	Q3'2022	Q3'2023	y/y change
Yield from interest-earning assets	7.3%	7.7%	0.4%
Cost of funding	2.9%	3.7%	0.8%
Cost of risk	9.5%	14.6%	5.1%
Net Interest Margin	7.3%	5.6%	(1.7%)
Net Interest Income as % of operating income	58.6%	55.7%	(3.0%)
Non-Funded Income as a % of operating income	41.4%	44.3%	3.0%
Cost to Income Ratio	56.6%	64.8%	8.2%
CIR without LLP	47.1%	50.2%	3.1%
Cost to Assets	3.8%	4.3%	0.5%

Capital Adequacy Ratios	Q3'2022	Q3'2023	% points change
Core Capital/Total Liabilities	16.9%	17.7%	0.8%
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess	**8.9%**	**9.7%**	**0.8%**
Core Capital/Total Risk Weighted Assets	16.1%	15.2%	(0.9%)
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess	**5.6%**	**4.7%**	**(0.9%)**
Total Capital/Total Risk Weighted Assets	20.7%	19.2%	(1.5%)
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess	**6.2%**	**4.7%**	**(1.5%)**
Liquidity Ratio	51.8%	0.0%	(51.8%)
Minimum Statutory ratio	20.0%	20.0%	0.0%
Excess	**31.8%**	**(20.0%)**	**(51.8%)**

Income Statement

- Core earnings per share increased by 5.3% to Kshs 9.6 from Kshs 9.1 in Q3’2022, mainly driven by the 27.8% growth in total operating income to Kshs 130.4 bn, from Kshs 102.1 bn in Q3’2022. However, the performance was weighed down by a 46.3% growth in total operating expenses to Kshs 84.5 bn, from Kshs 57.7 bn in Q3’2022,
- The 27.8% growth in total operating income was mainly driven by a 21.3% growth in Net Interest Income to Kshs 72.6 bn, from Kshs 59.8 bn in Q3’2022, coupled with a 36.9% growth in Non funded Income (NFI) to Kshs 57.8 bn, from Kshs 42.2 bn in Q3’2022,
- Interest income grew by 32.0% to Kshs 111.1 bn from Kshs 84.2 bn in Q3’2022, mainly driven by a 31.3% growth in interest income from loans and advances to Kshs 70.6 bn from Kshs 53.7 bn in Q3’2022. As such, the Yield on Interest-Earning Assets (YIEA) increased to 8.6% from 7.3% recorded in Q3’2022, mainly attributable to the faster 32.0% growth in interest income compared to a 18.6% increase in average interest earning assets to Kshs 1304.1 bn, from Kshs 1099.9 bn in Q3’2022,
- Interest expense increased by 58.4% to Kshs 38.5 bn in Q3’2023 from Kshs 24.3 bn in Q3’2022, largely due to a 58.4% increase in interest expense on customer deposits to Kshs 26.1 bn from Kshs 16.5 bn in Q3’2022, coupled with 91.7% increase in interest expenses on placements to Kshs 3.9 bn from Kshs 2.0 bn in Q3’2022. Consequently, Cost of funds (COF) increased by 0.8% points to 3.7% from 2.9% recorded in Q3’2022, owing to a faster 52.7% increase in Trailing interest expense to Kshs 47.8 bn, from Kshs 31.4 bn recorded in Q3’2022, compared to a 20.0% increase in average interest bearing liabilities to Kshs 1283.3 bn from Kshs 1069.4 bn in Q3’2022. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. On the other hand, Net Interest Margin (NIM) decreased to 5.6% from 7.3% in Q3’2022, attributable to the 9.4% decrease in trailing Net Interest Income (NII) to Kshs 72.6 bn from Kshs 80.2 bn in Q3’2023 relative to the 18.6% growth in average interest-earning assets,
- Non-Funded Income (NFI) increased by 36.9% to Kshs 57.8 bn from Kshs 42.2 bn in Q3’2022, mainly driven by a 56.3% increase in the foreign exchange trading income to Kshs 13.9 bn from Kshs 8.9 bn in Q3’2022, highlighting the bank’s increased foreign exchange margins. Total fees and commissions increased by 36.6% to Kshs 36.5 bn, from Kshs 26.7 bn in Q3’2022. The revenue mix shifted to 56:44 from 59:41 for the funded to Non-funded income owing to the 21.3% growth in Funded Income which was slower than the 36.9% growth in the Non Funded Income,
- Total operating expenses increased by 46.3% to Kshs 84.5 bn from Kshs 57.7 bn in Q3’2022, driven by 96.6% increase in loan loss provisions to Kshs 19.0 bn from Kshs 9.7 bn recorded in Q3’2022, coupled with a 33.0% increase in staff costs to Kshs 23.1 bn from Kshs 17.3 bn in Q3’2022. 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 48.0 in Q3’2023 which was below the 50.0 points, despite the slight improvement from an average of 47.4 in Q3’2022,
- Cost to Income Ratio (CIR) increased to 64.8% from 56.6% in Q3’2022, owing to the 46.3% increase in total operating expense, which outpaced the 27.8% increase in total operating income. Notably, CIR without LLP increased by 3.1% points to 50.2% from 47.1% recorded in Q3’2022, and,
- Profit before tax increased by 3.6% to Kshs 45.9 bn from Kshs 44.3 bn in Q3’2022, with effective tax rate declining to 21.1% in Q3’2023 from 22.4% in Q3’2022. As such, profit after tax increased by 5.3% to Kshs 36.2 bn in Q3’2023, from Kshs 34.4 bn in Q3’2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 24.0% to Kshs 1691.2 bn, from Kshs 1363.7 bn in Q3’2022, mainly attributable to the 25.5% growth in net loans and advances to Kshs 845.9 bn in Q3’2023 from Kshs 673.9 bn in Q3’2022, coupled with 4.1% increase in investment in government securities to Kshs 233.0 bn, from Kshs 242.5 bn recorded in Q3’2022

- Total liabilities grew by 23.8% to Kshs 1497.9 bn, from Kshs 1209.7 bn in Q3’2022, largely attributable to a 19.9% growth in customer deposits to Kshs 1207.7 bn in Q3’2023, from Kshs 1007.3 bn in Q3’2022, coupled with a 119.9% growth in placements to Kshs 78.1 bn from Kshs 35.5 bn recorded in Q3’2022.
- The faster 25.5% growth in loans as compared to the 19.9% growth in deposit led to an increase in the loan to deposits ratio to 70.0%, from 66.9% in Q3’2022,
- Gross Non-Performing Loans (NPLs) increased by 83.5% to Kshs 124.5 bn in Q3’2023 from Kshs 67.9 bn in Q3’2022, while Gross Loans increased by 27.3% to Kshs 912.4 bn from Kshs 716.6 bn in Q3’2022. Consequently, the asset quality deteriorated with the NPL ratio rising to 13.6% in Q3’2023 from 9.5% in Q3’2022,
- General Provisions (LLP) increased by 57.4% to Kshs 45.0 bn in Q3’2023 from Kshs 28.6 bn in Q3’2022. The NPL coverage decreased to 53.4% in Q3’2023, from 63.0% in Q3’2022, attributable to the 57.4% increase in provisions coupled with 51.6% increase in interest in suspense to Kshs 21.4 bn from 14.1 bn recorded in Q3’2022, which offset the 83.5% increase in gross non-performing loans,
- Shareholders’ funds increased by 24.7% to Kshs 183.9 bn in Q3’2023, from Kshs 147.5 bn in Q3’2022, supported by a 16.4% increase in retained earnings to Kshs 209.1 bn, from Kshs 179.6 bn in Q3’2022,
- Equity Group remained capitalized with a core capital to risk-weighted assets ratio of 15.2%, 4.7% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 19.2%, exceeding the statutory requirement of 14.5% by 4.7% points, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.4%, and a Return on Average Equity (ROaE) of 21.8%.

Key Take-Outs:

1. **Strong earnings growth -** Core earnings per share (EPS) grew by 5.3% to Kshs 9.6, from Kshs 9.1 in Q3’2022, mainly driven by the 27.8% growth in total operating income to Kshs 130.4 bn, from Kshs 102.1 bn in Q3’2022. However, the performance was weighed down by a 46.3% growth in total operating expenses to Kshs 84.5 bn, from Kshs 57.7 bn in Q3’2022,
2. **Increased Provisioning –** On the back of high credit risk occasioned 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 96.6% to Kshs 19.0 bn from Kshs 9.7 bn recorded in Q3’2022, and,
3. **Revenue Diversification –** The Group’s Non-Funded income increased by 36.9% to Kshs 57.8 bn in Q3’2023, from Kshs 42.2 bn in Q3’2022, which resulted to a shift in revenue mix to 56:44 in Q3’2023 from 59:41 in Q3’2022. The increase was mainly attributable to the faster 36.9% increase in non-funded income compared to the 21.3% increase in Funded income to kshs 72.6 bn, from kshs 59.8 bn in Q3’2022:

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

- **Geographical Diversification** – The bank has been aggressively expanding into other regions, namely DRC, Rwanda, Tanzania, Uganda and Ethiopia. On 14 June 2023, the bank announced that it had entered into a binding agreement with Government of Rwanda, Rwanda Social Security Board and other investors of Compagnie Generale De Banque (Cogebanque) Plc Limited to acquire a 91.9% stake in the Rwanda based lender. Upon the completion of the acquisition, EGH plans to eventually merge the business of the Cogebanque with its Rwandan Subsidiary, Equity Bank Rwanda Plc. Notably, in Q3’2023, EquityBCDC – a subsidiary in Congo recorded the highest growth in profit after tax by 142.0% to Kshs 11.4 bn from Kshs 4.7 bn recorded in Q3’2022.

Valuation Summary

- We are of the view that Equity Group is a “buy” with a target price of Kshs 45.3 representing an upside of 31.3%, from the current price of Kshs 38.3 as of 24th November 2023, inclusive of a dividend yield of 10.4%.
- Equity Group is currently trading at a P/TBV of 0.3x and a P/E of 3.2x vs an industry average of 0.8x and 3.5x respectively.