Cytonn INVESTMENTS

Equity Group Holdings Plc – H1'2021

20th August, 2021

Below is a summary of Equity Group Holdings Plc H1'2021 performance:

Balance Sheet Items (Kshs bn)	H1'2020	H1'2021	y/y change
Government Securities	181.2	202.6	11.8%
Net Loans and Advances	391.6	504.8	28.9%
Total Assets	**746.5**	**1,119.7**	**50.0%**
Customer Deposits	543.9	819.7	50.7%
Total Liabilities	623.1	964.7	54.8%
Shareholders' Funds	**122.2**	**148.2**	**21.2%**

Balance Sheet Ratios	H1'2020	H1'2021	% points y/y change
Loan to Deposit Ratio	72.0%	61.6%	(10.4%)
Return on average equity	17.5%	21.4%	3.9%
Return on average assets	2.8%	3.1%	0.3%

Income Statement (Kshs bn)	H1'2020	H1'2021	y/y change
Net Interest Income	24.6	31.2	26.5%
Net non-Interest Income	14.4	20.8	44.2%
Total Operating income	**39.0**	**51.9**	**33.0%**
Loan Loss provision	(8.0)	(2.9)	(63.7%)
Total Operating expenses	(27.1)	(28.1)	3.8%
Profit before tax	12.0	23.8	99.0%
Profit after tax	**9.1**	**17.9**	**97.7%**
Core EPS	**2.4**	**4.8**	**97.7%**

Income Statement Ratios	H1'2020	H1'2021	% points y/y change
Yield from interest-earning assets	10.8%	10.3%	(0.5%)
Cost of funding	2.9%	2.9%	0.0%
Cost of risk	20.6%	5.6%	(15.0%)
Net Interest Margin	8.1%	7.6%	(0.5%)
Net Interest Income as % of operating income	63.1%	60.0%	(3.1%)
Non-Funded Income as a % of operating income	36.9%	40.0%	3.1%
Cost to Income Ratio	69.3%	54.1%	(15.2%)
CIR without LLP	48.8%	48.5%	(0.3%)
Cost to Assets	2.7%	2.7%	0.0%

Capital Adequacy Ratios	H1'2020	H1'2021
Core Capital/Total Liabilities	20.3%	15.8%
Minimum Statutory ratio	8.0%	8.0%
Excess	**12.3%**	**7.8%**
Core Capital/Total Risk Weighted Assets	16.9%	14.0%
Minimum Statutory ratio	10.5%	10.5%
Excess	**6.4%**	**3.5%**
Total Capital/Total Risk Weighted Assets	20.2%	17.5%
Minimum Statutory ratio	14.5%	14.5%
Excess	**5.7%**	**3.0%**
Liquidity Ratio	54.2%	62.4%
Minimum Statutory ratio	20.0%	20.0%
Excess	**34.2%**	**42.4%**

Adjusted core capital/ total deposit liabilities	20.6%	15.8%
Adjusted core capital/ total risk weighted assets	17.1%	14.1%
Adjusted total capital/ total risk weighted assets	20.5%	17.6%

Key Highlights

- In May 2021, Equity Group disclosed that it had acquired an additional 7.7% stake valued at Kshs 996.0 mn, in Equity bank Congo (EBC) from the German Sovereign Wealth Fund (KfW). The acquisition raised the total ownership in EBC to 94.3%, indicating that they are currently valuing the company at Kshs 14.2 bn. This follows the recent acquisition of 66.5% stake in Banque Commerciale Du Congo (BCDC) by Equity Group at a cost of Kshs 10.2 bn in August 2020. For more information, please see Cytonn Weekly#20/2021

Income Statement

- Core earnings per share increased by 97.7% to Kshs 4.8 in H1'2021, from Kshs 2.4 recorded in H1'2020, better than our projections of a 65.5% increase to Kshs 4.0. The performance was driven by a 33.0% growth in total operating income to Kshs 51.9 bn, outpacing the 3.8% growth in total operating expenses to Kshs 28.1 bn, from Kshs 27.1 bn in H1'2020. The variance in core earnings per share growth against our expectations was due to the Non-Funded Income increasing by 44.2% against our expectation of a 10.3% growth in H1'2021,
- Total operating income rose by 33.0% to Kshs 51.9 bn, from Kshs 39.0 bn recorded in H1'2020. This was driven by a 44.2% increase in Non-Funded Income (NFI) to Kshs 20.8 bn, from Kshs 14.4 bn in H1'2020, coupled with a 26.5% increase in Net Interest Income (NII) to Kshs 31.2 bn, from Kshs 24.6 bn in H1'2020,
- Interest income increased by 30.3% to Kshs 42.7 bn, from Kshs 32.8 bn in H1'2020 driven by a 29.8% increase in interest income on loans and advances to Kshs 29.2 bn, from Kshs 22.5 bn in H1'2020, coupled with a 30.2% increase in interest income from government securities to Kshs 12.7 bn, from Kshs 9.8 bn in H1'2020. The Yield on Interest-Earning Assets, however, declined to 10.3%, from 10.8% in H1'2020, as the average interest-earning assets grew faster, by 36.1% to Kshs 815.2 bn, from Kshs 599.1 bn in H1'2020 compared to the 29.1% 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 42.0% to Kshs 11.6 bn, from Kshs 8.2 bn in H1'2020, following a 51.1% increase in interest expense on customer deposits to Kshs 9.3 bn, from Kshs 6.1 bn in H1'2020, coupled with a 19.5% increase in other interest expenses to Kshs 2.1 bn, from Kshs 1.8 bn in H1'2020. The rise in interest expense was however mitigated by a 17.6% decline in interest expense on deposits and placements from banking institutions to Kshs 0.2 bn, from Kshs 0.3 bn in H1'2020. Cost of funds, on the other hand, declined marginally by 0.03% points to 2.89%, from 2.92% in H1'2020, owing to the faster 36.5% growth in average interest-bearing liabilities, which outpaced the 35.3% growth in the trailing interest expense. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) declined to 7.6% from 8.1% in H1'2020, attributable to the 36.1% growth in average interest-earning assets, which outpaced the 27.1% growth of trailing Net Interest Income (NII),
- Non-Funded Income (NFI) rose by 44.2% to Kshs 20.8 bn, from Kshs 14.4 bn in H1'2020. The increase was mainly driven by an 41.6% increase in Fees and commissions on loans and advances to Kshs 3.5 bn, from Kshs 2.5 bn in H1'2020, coupled with an 82.8% growth in Foreign Exchange Trading income to Kshs 4.1 bn, from Kshs 2.2 bn in H1'2020 and a 42.8% growth in Other fees and commissions income to Kshs 9.7 bn, from Kshs 6.8 bn in H1'2020. Equity Group's total fees and commission increased by 42.5% to Kshs 13.1 bn, from Kshs 9.2 bn in H1'2020, boosted by fees and commissions growth recorded in the Group's subsidiaries. Equity Bank Kenya's total fees and commissions increased by 7.7% to Kshs 7.0 bn in H1'2021, from Kshs 6.5 bn recorded in H1'2020, while the subsidiaries' total fees and commissions

increased by 126.5% to Kshs 6.1 bn from Kshs 2.7 bn recorded in H1'2020. Notably, the revenue mix shifted to 60:40 from 63:37, funded to non-funded income, recorded in H1'2020, owing to the faster 44.2% increase in non-funded income compared to the 26.5% growth in net funded income,

- Total operating expenses grew by 3.8% to Kshs 28.1 bn in H1'2021, from Kshs 27.1 bn recorded in H1'2020, mainly driven by Staff Costs, which increased by 26.8% to Kshs 8.5 bn in H1'2021 from Kshs 6.7 bn recorded in H1'2020, coupled with an increase in Other operating expenses of 35.3% to Kshs 16.7 bn in H1'2021 from Kshs 12.3 bn recorded in H1'2020. The rise in total operating expenses was however mitigated by a 63.7% decline in Loans Loss Provision to Kshs 2.9 bn in H1'2021 from Kshs 8.0 bn recorded in H1'2020. The reduced provision level was on the back of increased business activities during the half driven by the gradual recovery of the operating environment,
- As a result of the 63.7% decrease in Loans Loss Provisions (LLP), Cost to Income Ratio (CIR) with LLP improved by 15.2% points to 54.1%, from 69.3% in H1'2020. Without LLP, the cost to income ratio improved by 0.3% points to 48.5%, from 48.8% in H1'2020, an indication of an improvement in the Banks efficiency levels,
- Profit before tax increased by 99.0% to Kshs 23.8 bn, from Kshs 12.0 bn in H1'2020. Profit after tax increased by 97.7% to Kshs 17.9 bn in H1'2021, from Kshs 9.1 bn recorded in H1'2020 with the effective tax rate increasing to 24.7% from 24.2% in H1'2020.

Balance Sheet

- The balance sheet recorded an expansion as Total Assets increased by 50.0% to Kshs 1.1 tn in H1'2021, from Kshs 0.7 tn recorded in H1'2020. This growth was largely driven by the 28.9% growth of the loan book to Kshs 504.8 bn, from Kshs 391.6 bn recorded in H1'2020, coupled with a 11.8% growth in Government securities to Kshs 202.6 bn in H1'2021, from Kshs 181.2 bn in H1'2020. The remarkable expansion in the balance sheet is also partly attributable to the 66.5% stake acquisition of Congolese lender, Banque Commerciale Du Congo (BCDC) in August 2020. BCDC contributed Kshs 328.3 bn worth of assets in H1'2021 to the Group,
- Total liabilities rose by 54.8% to Kshs 964.7 bn, from Kshs 623.1 bn in H1'2020, driven by a 50.7% increase in customer deposits to Kshs 819.7 bn, from Kshs 543.9 bn in H1'2020. Key to note, the strong growth in customer deposits is mainly attributable to the acquisition of BCDC, with the subsidiary contributing Kshs 274.8 bn to the total deposits. Deposits per branch increased by 34.2% to Kshs 2.4 bn, from Kshs 1.8 bn in H1'2020, with the number of branches increasing by 37 to 337 branches in H1'2021, from 300 in H1'2020, with Equity BCDC contributing 26 additional branches,
- The faster 50.7% growth in customer deposits as compared to the 28.9% growth in loans, led to a decline in the Loans to deposit ratio to 61.6% from 72.0% in H1'2020,
- Gross Non-Performing Loans (NPLs) increased by 36.5% to Kshs 62.2 bn in H1'2021, from Kshs 45.6 bn recorded in H1'2020. The NPL ratio rose to 11.4% in H1'2021, from 11.0% recorded in H1'2020, attributable to the faster 36.5% growth in Gross Non-Performing Loans (NPLs), compared to the 31.5% increase in gross loans. The main sectors that contributed to the deterioration in asset quality were micro enterprises sectors and SMEs, which contributed the largest portion of the Non-Performing loans with NPL Ratios of 17.4% and 14.9%, respectively. The group's Tanzanian subsidiary recorded the highest NPL ratio, coming in at 29.9% in H1'2021, with Equity Bank Kenya recording an NPL ratio of 11.1% in H1'2021. With the general Loan Loss Provisions increasing by 90.0% to Kshs 31.0 bn, from Kshs 16.3 bn in H1'2020, higher than the 36.5% rise in the Gross Non-Performing Loans, the NPL coverage improved to 63.2%, from 48.5% in H1'2020, an indication of sufficient provisioning,
- Shareholders' funds grew by 21.2% to Kshs 148.2 bn in H1'2021, from Kshs 122.2 bn in H1'2020, mainly supported by a 26.1% growth in retained earnings to Kshs 136.4 bn, from Kshs 108.2 bn in H1'2020,
- Equity Group is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 14.0%, 3.5% points above the minimum statutory requirement. In addition, the total capital to risk-weighted assets ratio was 17.5%, exceeding the minimum statutory requirement by 3.0% points. Adjusting for IFRS

9, the core capital to risk-weighted assets stood at 14.1% while total capital to risk-weighted assets came in at 17.6%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.1%, and a Return on Average Equity (ROaE) of 21.4%.

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 21.0% to the bank’s total profitability and 39.0% to the group’s total asset base. However, given the high NPL levels in the group’s Tanzania subsidiary of 29.9%, 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 86.2% growth in their Profit after Tax (PAT) to Kshs 3.5 bn, from Kshs 1.9 bn in H1’2020, with the Tanzanian subsidiary recording a y/y growth of 181.0% to a profit of Kshs 0.1 bn in H1’2021, from a recorded loss of Kshs 0.2 bn in H1’2020, while the DRC subsidiary, Equity BCDC, recorded a growth of 447.0% in their Profit After Tax to Kshs 1.6 bn in H1’2021 from Kshs 0.6 bn in H1’2020. Total assets in the bank’s regional subsidiaries, excluding Equity Bank Kenya Ltd, grew by 87.0% to Kshs 345.0 bn in H1’2021, from Kshs 184.5 bn in H1’2020, attributable to the acquisition of the Banque Commerciale Du Congo (BCDC),
2. Equity Group’s Return on average Equity (ROaE) rose by 0.9% points to 25.0% in H1’2021 up from 15.4% recorded in H1’2020, led by the Kenyan subsidiary which recorded an ROaE of 31.9% followed by the Ugandan, and the Rwandese subsidiaries which recorded ROaEs of 25.7% and 25.4%, respectively, in H1’2021. In H1’2021, Equity Bank Kenya recorded a Return on average Assets (ROaA) of 4.0% which was weighed down by the other subsidiaries to bring the Group’s ROaA to 3.3%. The South Sudan subsidiary recorded an ROaA of (9.2%) as it recorded a loss after tax of Kshs 0.5 bn in H1’2021,
3. Equity Group’s recorded a remarkable increase in its balance sheet, as Total Assets increased by 50.0% to Kshs 1.1 tn, from Kshs 0.7 tn recorded in H1’2020 despite the challenging business environment. The increase is largely attributable to the Group’s 66.5% stake acquisition of Congolese lender, Banque Commerciale Du Congo (BCDC). BCDC contributed Kshs 328.3 bn worth of assets in H1’2021 to the Group. 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,
4. 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 87.2% 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 61.4%, 34.3% and 4.2%, 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,
5. The bank’s asset quality deteriorated, as evidenced by the 0.4% points rise in the NPL ratio to 11.4% in H1’2021, from 11.0% in H1’2020. The main sectors that contributed to the deterioration in asset quality were micro enterprises sectors and SMEs, which contributed the largest portion of the Non-Performing loans with NPL Ratios of 17.4% and 14.9%, respectively. The Group’s Tanzanian subsidiary saw it’s NPL ratio improve by 12.1% points to 29.9% in H1’2021 from 42.0% recorded in H1’2020, partly attributable to improved credit assessment, while Equity Bank Kenya recording an NPL ratio of 11.1% in H1’2021. 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 marginally in FY’2021.

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, and,

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 62.4%, loan deposit ratio of 61.6% and a core capital to risk-weighted asset ratio of 14.0%.

Valuation Summary

- We are of the view that Equity Group is an "***Hold***" with a target price of Kshs 56.2 representing an upside of 7.0%, from the current price of Kshs 52.5 as of 20th August 2021,
- Equity Group is currently trading at a P/TBV of 1.4x and a P/E of 6.8x vs an industry average of 1.1x and 8.8x, respectively.