Valuation Summary

- We are of the view that Equity Group is an "Buy" with a target price of Kshs 59.5, representing an upside of 61.6%, from the current price of Kshs 36.8 as of 13th November 2020,
- Equity Group is currently trading at a P/TBV of 1.1x and a P/E of 6.9x vs an industry average of 1.0x and 6.9x, respectively.

Key Highlights Q3'2020

- The Group completed the 66.5% stake acquisition of the Banque Commerciale Du Congo (BCDC) at a cost of USD 95.0 mn (Kshs 10.3 bn). Following the acquisition, BCDC became Equity Groups subsidiary increasing Equity's subsidiaries in the DRC to two, and,
- Equity Group partnered with Proparco, a French Development Finance Institution in order to issue USD 100.0 mn (Kshs 108.5 bn) loans to support MSMEs affected by the pandemic in Kenya.

Income Statement

- Core earnings per share declined by 13.9% to Kshs 4.0, from Kshs 4.6 in Q3'2019, better than our projections of a 41.7% decline to Kshs 2.7. The performance was driven by a 50.7% increase in total operating expenses, outpacing the 17.0% growth recorded in total operating income. The variance in core earnings per share growth against our expectations was due to the 17.0% growth in total operating income to Kshs 64.1 bn, from Kshs 54.8 bn in Q3'2019, against our expectation of a 27.3% decline to Kshs 39.8 bn,
- Total operating income rose by 17.0% to Kshs 64.1 bn, from Kshs 54.8 bn in Q3'2019. This was driven by a 21.8% rise in Net Interest Income (NII) to Kshs 39.3 bn, from Kshs 32.3 bn in Q3'2019, coupled with a 10.1% growth in Non-Funded Income to Kshs 24.8 bn from Kshs 22.5 bn in Q3'2019,
- Interest income rose by 21.7% to Kshs 52.1 bn, from Kshs 42.8 bn in Q3'2019. This was driven by a 24.4% increase in interest income on loans and advances to Kshs 36.0 bn, from Kshs 29.0 bn in Q3'2019, coupled with a 21.9% increase in interest income on government securities to Kshs 15.4 bn, from Kshs 12.6 bn in Q3'2019. The yield on interest-earning assets declined to 10.1%, from 10.9% in Q3'2019, due to the faster 29.2% growth in average interest- earning assets, which outpaced the 19.9% growth in trailing interest income,
- Interest expense rose by 21.6% to Kshs 12.8 bn from Kshs 10.5 bn in Q3'2019, following a 17.9% increase in interest expense on customer deposits to Kshs 9.6 bn, from Kshs 8.1 bn in Q3'2019, coupled with a 36.8% increase in other interest expenses to Kshs 2.6 bn from Kshs 1.9 bn in Q3'2019. Interest expenses on deposits and placements grew by 5.1% to Kshs 0.6 bn, from Kshs 0.5 bn in Q3'2019. Cost of funds declined marginally to 2.6%, from 2.7% recorded in Q3'2019, owing to the faster 30.2% growth in average interest-bearing liabilities to Kshs 653.0 bn, from Kshs 501.4 bn recorded in Q3'2019, outpacing the 21.6% increase in interest expense. Net Interest Margin (NIM) declined to 7.6% from 8.4% in Q3'2019, owing to the faster 29.2% growth in average interest earning assets which outpaced the 21.8% growth in Net Interest Income (NII),
- Non-Funded Income (NFI) rose by 10.1% to Kshs 24.8 bn, from Kshs 22.5 bn in Q3'2019, mainly driven by a 41.0% increase in forex trading income to Kshs 4.0 bn, from Kshs 2.8 bn in Q3'2019, coupled with a 2.1% increase in total fees and commissions on loans to Kshs 4.4 bn, from Kshs 4.3 bn. The increase was however weighed down by a 2.6% decline in other fees and commission income to Kshs 11.1 bn from Kshs 11.4 bn in Q3'2019. Key to note, the sluggish growth in total fees and commission on loans can be attributed to the impact the waiver on mobile banking fees has had on the group. As a result, the revenue mix shifted to 61:39 from 59:41 funded to non-funded income, owing to the faster 21.8% growth in NII as compared to the 10.1% growth in NFI,
- Total operating expenses rose by 50.7% to Kshs 45.3 bn, from Kshs 30.0 bn in Q3'2019, largely driven by a 686.1% increase in Loan Loss Provisions (LLP) to Kshs 14.8 bn, from Kshs 1.9 bn in Q3'2019, on the back of the subdued business environment, coupled with a 16.2% rise in staff costs to Kshs 10.8 bn, from Kshs 9.3 bn in Q3'2019,

- As a result of the 686.1% rise in Loan Loss Provisions (LLP), Cost to Income Ratio (CIR) deteriorated by 15.8% points to 70.6%, from 54.8% in Q3’2019. Without LLP, the CIR improved by 3.8% points to 47.6%, from 51.4% in Q3’2019 an indication of an improvement in the Banks efficiency levels, and,
- Profit before tax declined by 20.3% to Kshs 19.8 bn, down from Kshs 24.8 bn in Q3’2019. Profit after tax recorded a 13.9% decline to Kshs 15.0 bn, from Kshs 17.5 bn, with the effective tax rate declining to 23.9% from 29.5% in Q3’2019.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 37.9% to Kshs 933.9 bn, from Kshs 677.1 bn in Q3’2019. The growth was supported by a 37.2% increase in the government securities to Kshs 185.3 bn, from Kshs 135.1 bn, coupled with a 30.1% increase in loan book to Kshs 453.9 bn from Kshs 348.9 bn in Q3’2019,
- Total liabilities rose by 40.1% to Kshs 796.3 bn from Kshs 568.4 bn in Q3’2019, driven by a 44.5% increase in customer deposits to Kshs 691.0 bn, from Kshs 478.1 bn in Q3’2019. Key to note, the strong growth in customer deposits is mainly attributable to the acquisition of BCDC, with the subsidiary contributing Kshs 130.0 bn to the total deposits. Deposits per branch increased by 43.8% to Kshs 2.3 bn, from Kshs 1.6 bn in Q3’2019, with the number of branches increasing by 6 to 300 branches in Q3’2020, from 294 in Q3’2019. Borrowings recorded a growth of 19.0% to Kshs 68.5 bn, from Kshs 57.6 bn in Q3’2019,
- The faster 44.5% growth in deposits as compared to the 30.1% growth in loans, led to a decline in the loan to deposit ratio to 65.7%, from 73.0% in Q3’2019,
- Gross Non-Performing Loans (NPLs) rose by 69.4% to Kshs 51.8 bn in Q3’2020, from Kshs 30.5 bn in Q3’2019. Consequently, the NPL ratio deteriorated to 10.8% in Q3’2020, from 8.4% in Q3’2019, attributable to a faster 69.4% growth in Non-Performing Loans, which outpaced the 32.5% growth in gross loans. The main sectors that contributed to the deterioration in asset quality were large enterprises and SMEs sectors, which contributed the largest portion of the Non-Performing loans with NPL Ratios of 11.1% and 12.4%, respectively. The group’s South Sudan and Tanzania subsidiary also recorded a high NPL ratios of 51.5% and 37.8%, respectively, in Q3’2020. With general Loan Loss Provisions increasing by 110.9% to Kshs 21.1 bn, from Kshs 10.0 bn in Q3’2019, higher than the 69.4% rise in Non-performing loans, the NPL coverage improved to 52.0% in Q3’2020 from 45.8% in Q3’2019,
- Shareholders’ Funds grew by 21.4% to Kshs 130.7 bn in Q3’2020 from Kshs 107.7 bn in Q3’2019, supported by a 20.2% increase in retained earnings to 114.0 bn from Kshs 94.8 bn,
- Equity Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 14.5%, 4.0% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 17.5%, exceeding the statutory requirement of 14.5% by 3.0% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 14.8%, while total capital to risk-weighted assets came in at 17.7%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.5%, and a Return on Average Equity (ROaE) of 16.9%.

Key Take-Outs:

1. The bank’s geographical diversification strategy has continued to emerge as a net positive, with the bank’s various subsidiaries in Uganda, DRC, Rwanda, Tanzania, South Sudan cumulatively contributing 18.0% of the bank’s total profitability and 40.0% of the group’s total asset base. However, given the high NPL levels in the group’s South Sudan and Tanzania subsidiary of 51.5% and 37.8%, the group will need to improve its credit assessment in these countries to bring down the high NPL ratios. Cumulatively, the group’s subsidiaries recorded a 6.5% growth in their Profit after Tax (PAT) to Kshs 3.3 bn, from Kshs 3.1 bn in Q3’2019, with the Tanzanian branch recording a loss of Kshs 0.2 bn in Q3’2020 from the earlier recorded PAT of Kshs 0.1 bn in Q3’2019. Total assets in the bank’s regional subsidiaries grew by 96.7% to Kshs 377.2 bn in Q3’2020, from Kshs 191.8 bn in Q3’2019, attributable to the acquisition of the Banque Commerciale Du Congo (BCDC). Improved efficiencies in the

subsidiaries saw their cost structure contribution to the Group, improve to 39.0%, from 36.0% in Q3'2019,

2. Increased innovation and digitization have seen 98.0% of all transactions of the bank being done on alternative channels, with mobile transactions taking up 82.9% of all transactions, and agency banking contributing 9.1% of all transactions. However, in terms of the value of transactions, branches contributed 41.4% of the value of all transactions, while mobile and agency banking contributed 32.5% and 18.1%, respectively. This highlights the transformation of branches to handle high-value transactions. This transformation aids the bank by offering its ecosystem banking products to corporate and SME clients,
3. Despite the recent waiver of banking and mobile money transactions unveiled by the Central Bank of Kenya as a measure to cushion citizens against the effects of the COVID-19 pandemic, the group recorded an increase in Non-Funded Income (NFI) by 10.1% to Kshs 24.8 bn, from Kshs 22.5 bn in Q3'2019. This was mainly driven by a 41.0% increase in forex trading income to Kshs 4.0 bn, from Kshs 2.8 bn in Q3'2019, coupled with a 2.1% increase in total fees and commissions on loans to Kshs 4.4 bn, from Kshs 4.3 bn. The increase was however weighed down by a 2.6% decline in other fees and commission income to Kshs 11.1 bn from Kshs 11.4 bn in Q3'2019, and,
4. The bank's asset quality deteriorated, as evidenced by the rise in the NPL ratio to 10.8% in Q3'2020, from 8.4% in Q3'2019. The main sectors that contributed to the deterioration in asset quality were large enterprises and SMEs sectors, which contributed the largest portion of the Non-Performing loans with NPL Ratios of 11.1% and 12.4%, respectively. Key to note, the groups South Sudan and Tanzania subsidiaries recorded high NPL ratios of 51.5% and 37.8%, respectively. The subsidiaries contributed 3.0% of the group's loan book. With the reduction of business revenue due to the slowed down business operations, more so in the Private sector, we expect the groups asset quality to continue deteriorating.

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

I. Channelled 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 55.7%, loan deposit ratio of 65.7% and a core capital to risk-weighted asset ratio of 14.5%.

Below is a summary of the bank's performance:

Balance Sheet Items	Q3'2019	Q3'2020	y/y change	Q3'2020e	Expected y/y change	Variance in Growth Actual vs. Expected
Government Securities	135.1	185.3	37.2%	174.6	29.3%	(7.9%)
Net Loans and Advances	348.9	453.9	30.1%	412.6	18.2%	(11.8%)
Total Assets	**677.1**	**933.9**	**37.9%**	**770.9**	**13.8%**	**(24.1%)**
Customer Deposits	478.1	691.0	44.5%	568.2	18.8%	(25.7%)
Total Liabilities	568.4	796.3	40.1%	647.4	13.9%	(26.2%)
Shareholders' Funds	**107.7**	**130.7**	**21.4%**	**122.4**	**13.6%**	**(7.7%)**

Balance Sheet Ratios	Q3'2019	Q3'2020	% y/y change
Loan to Deposit Ratio	73.0%	65.7%	(7.3%)
Return on average equity	21.7%	16.9%	(4.9%)

Return on average assets	3.5%	2.5%	(1.0%)

Income Statement	Q3'2019	Q3'2020	y/y change	Q3'2020e	Expected y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	32.3	39.3	21.8%	24.2	(25.0%)	(46.7%)
Net non-Interest Income	22.5	24.8	10.1%	15.6	(30.7%)	(40.8%)
Total Operating income	**54.8**	**64.1**	**17.0%**	**39.8**	**(27.3%)**	**(44.3%)**
Loan Loss provision	(1.9)	(14.8)	686.1%	(4.5)	139.4%	(546.7%)
Total Operating expenses	(30.0)	(45.3)	50.7%	(25.3)	(15.8%)	(66.5%)
Profit before tax	24.8	19.8	(20.3%)	14.6	(41.3%)	(21.0%)
Profit after tax	**17.5**	**15.0**	(13.9%)	**10.2**	(41.7%)	(27.8%)
Core EPS	**4.63**	**3.99**	(13.9%)	**2.70**	(41.7%)	(27.8%)

Income Statement Ratios	Q3'2019	Q3'2020	y/y change
Yield from interest-earning assets	10.9%	10.1%	(0.8%)
Cost of funding	2.7%	2.6%	(0.1%)
Cost of risk	3.4%	23.0%	19.6%
Net Interest Margin	8.4%	7.6%	(0.8%)
Net Interest Income as % of operating income	58.9%	61.3%	2.4%
Non-Funded Income as a % of operating income	41.1%	38.7%	(2.4%)
Cost to Income Ratio	54.8%	70.6%	15.8%
CIR without LLP	51.4%	47.6%	(3.8%)
Cost to Assets	4.6%	3.8%	(0.8%)

Capital Adequacy Ratios	Q3'2019	Q3'2020
Core Capital/Total Liabilities	19.8%	16.1%
Minimum Statutory ratio	8.0%	8.0%
Excess	**11.8%**	**8.1%**
Core Capital/Total Risk Weighted Assets	16.7%	14.5%
Minimum Statutory ratio	10.5%	10.5%
Excess	**6.2%**	**4.0%**
Total Capital/Total Risk Weighted Assets	20.5%	17.5%
Minimum Statutory ratio	14.5%	14.5%
Excess	**6.0%**	**3.0%**
Liquidity Ratio	54.2%	55.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	**34.2%**	**35.7%**
Adjusted core capital/ total deposit liabilities	20.7%	16.4%
Adjusted core capital/ total risk weighted assets	17.5%	14.8%
Adjusted total capital/ total risk weighted assets	21.2%	17.7%