Equity Group Holdings Plc – Q1’2021

28th May, 2021

Below is a summary of Equity Group Holdings Plc Q1’2021 performance:

Balance Sheet Items (Kshs bn)	Q1'2020	Q1'2021	y/y change
Government Securities	157.6	183.0	16.1%
Net Loans and Advances	379.2	487.7	28.6%
Total Assets	**693.2**	**1066.4**	**53.8%**
Customer Deposits	499.3	789.9	58.2%
Total Liabilities	576.8	926.0	60.5%
Shareholders’ Funds	**115.3**	**133.9**	**16.1%**

Balance Sheet Ratios	Q1'2020	Q1'2021	% point change
Loan to Deposit Ratio	75.9%	61.7%	(14.2%)
Return on average equity	20.7%	18.9%	(1.8%)
Return on average assets	3.3%	2.7%	(0.7%)

Income Statement (Kshs bn)	Q1'2020	Q1'2021	y/y change
Net Interest Income	11.5	14.8	28.4%
Net non-Interest Income	8.3	10.9	30.7%
Total Operating income	**19.9**	**25.7**	**29.3%**
Loan Loss provision	(3.1)	(1.3)	(59.3%)
Total Operating expenses	(12.9)	(14.0)	8.7%
Profit before tax	7.0	11.7	67.1%
Profit after tax	**5.3**	**8.7**	**63.8%**
Core EPS	**1.4**	**2.3**	**63.8%**

Income Statement Ratios	Q1'2020	Q1'2021	% point change
Yield from interest-earning assets	11.0%	10.3%	(0.7%)
Cost of funding	3.0%	2.8%	(0.2%)
Cost of risk	15.7%	4.9%	(10.8%)
Net Interest Margin	8.2%	7.6%	(0.6%)
Net Interest Income as % of operating income	58.1%	57.7%	(0.4%)
Non-Funded Income as a % of operating income	41.9%	42.3%	0.4%
Cost to Income Ratio	64.7%	54.4%	(10.3%)
CIR without LLP	49.0%	49.5%	0.4%
Cost to Assets	1.5%	1.4%	(0.1%)

Capital Adequacy Ratios	Q1'2020	Q1'2021
Core Capital/Total Liabilities	21.9%	15.8%
Minimum Statutory ratio	8.0%	8.0%
Excess	**13.9%**	**7.8%**
Core Capital/Total Risk Weighted Assets	17.5%	14.2%
Minimum Statutory ratio	10.5%	10.5%
Excess	**7.0%**	**3.7%**
Total Capital/Total Risk Weighted Assets	21.0%	18.0%
Minimum Statutory ratio	14.5%	14.5%
Excess	**6.5%**	**3.5%**
Liquidity Ratio	51.6%	60.6%
Minimum Statutory ratio	20.0%	20.0%
Excess	**31.6%**	**40.6%**
Adjusted core capital/ total deposit liabilities	22.2%	15.9%

Adjusted core capital/ total risk weighted assets	17.8%	14.3%
Adjusted total capital/ total risk weighted assets	21.3%	18.1%

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,
- During Q1’2021, Equity Group Holdings announced that it had secured four loan facilities amounting to Kshs 46.8 bn to sustain and scale their operations, as well as onward lending to MSMEs to bolster their resilience and growth during the COVID-19 environment. For more information, see our Cytonn Weekly #09/2021, and,
- Equity Group disclosed borrowers impacted by COVID-19 accounted for 31.0% of our loan portfolio as of Q1’2021. Loan restructuring fees waived amounted to Kshs 1.2 billion. This is in additional to a restructured loan amount of Kshs 171.0 bn in FY’2020. For more information, please see our Kenya Listed Banks FY’2020 Report.

Income Statement

- Core earnings per share increased by 63.8% to Kshs 2.3, from Kshs 1.4 recorded in Q1’2020, better than our projections of a 15.2% increase to Kshs 1.6. The performance was driven by a 29.3% growth in total operating income to Kshs 25.7 bn, outpacing the 8.7% growth in total operating expenses. The variance in core earnings per share growth against our expectations was due to the Non-Funded Income increasing by 30.7% against our expectation of a 4.2% growth in Q1’2021,
- Total operating income rose by 29.3% to Kshs 25.7 bn, from Kshs 19.9 bn recorded in Q1’2020. This was driven by a 30.7% increase in Non-Funded Income (NFI) to Kshs 10.9 bn, from Kshs 8.3 bn in Q1’2020, coupled with a 28.4% increase in Net Interest Income (NII) to Kshs 14.8 bn, from Kshs 11.5 bn in Q1’2020,
- Interest income increased by 31.9% to Kshs 20.3 bn, from Kshs 15.4 bn in Q1’2020 driven by a 31.5% increase in interest income on loans and advances to Kshs 14.2 bn, from Kshs 10.8 bn in Q1’2020, coupled with a 30.1% increase in interest income from government securities to Kshs 5.9 bn, from Kshs 4.5 bn in Q1’2020. The Yield on Interest-Earning Assets, however, declined to 10.3%, from 11.0% in Q1’2020, as the average interest-earning assets grew faster by 36.9% to Kshs 767.2 bn, from Kshs 560.4 bn in Q1’2020 compared to the 27.6% 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 42.4% to Kshs 5.5 bn, from Kshs 3.9 bn in Q1’2020, following a 47.6% increase in interest expense on customer deposits to Kshs 4.2 bn, from Kshs 2.8 bn in Q1’2020, coupled with an 137.0% increase in interest expense on deposits and placements from banking institutions to Kshs 0.3 bn, from Kshs 0.1 bn in Q1’2020. Cost of funds, on the other hand, declined marginally by 0.2% points to 2.8%, from 3.0% in Q1’2020, owing to the faster 38.2% growth in average interest-bearing liabilities, which outpaced the 30.2% 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 8.2% in Q1’2020, attributable to the 36.9% growth in average interest-earning assets, which outpaced the 26.8% growth of trailing Net Interest Income (NII),
- Non-Funded Income (NFI) rose by 30.7% to Kshs 10.9 bn, from Kshs 8.3 bn in Q1’2020. The increase was mainly driven by an 18.2% increase in Fees and commissions on loans and advances to Kshs 1.7 bn,

from Kshs 1.4 bn in Q1’2020, coupled with the 82.7% growth in Foreign Exchange Trading income to Kshs 2.0 bn, from Kshs 1.1 bn in Q1’2020. Equity Group’s total fees and commission also increased by 21.5% to Kshs 6.6 bn, from Kshs 5.4 bn in Q1’2020 boosted by fees and commissions growth recorded in the Group’s subsidiaries. Equity Bank Kenya’s total fees and commissions declined by 10.3% to Kshs 3.9 bn in Q1’2021, from Kshs 3.5 bn recorded in Q1’2020, while the subsidiaries’ total fees and commissions increased by 107.9% to Kshs 3.0 bn from Kshs 1.5 bn recorded in Q1’2020. Notably, the revenue mix remained unchanged at 58:42, funded to non-funded income, same as was recorded in Q1’2020,

- Total operating expenses grew by 8.7% to Kshs 14.0 bn in Q1’2021, from Kshs 12.9 bn recorded in Q1’2020, mainly driven by the 24.5% increase in Staff Costs to Kshs 4.0 bn, from Kshs 3.2 bn coupled with a 33.5% increase in Other operating expenses to Kshs 8.7 bn from Kshs 6.5 bn. On the other hand, Loans Loss Provision declined by 59.3% to Kshs 1.3 bn, from Kshs 3.1 bn recorded in Q1’2020. The reduced provision level was on the back of increased business activities during the quarter driven by the gradual recovery of the operating environment,
- As a result of the 59.3% decrease in Loans Loss Provisions, Cost to Income Ratio (CIR) improved to 54.4%, from 64.7% in Q1’2020. Without LLP, however, cost to income ratio deteriorated by 0.4% points to 49.5%, from 49.0% in Q1’2020, an indication of an indication of a decline in the Banks efficiency levels,
- Profit before tax increased by 67.1% to Kshs 11.7 bn, from Kshs 7.0 bn in Q1’2020. Profit after tax increased by 63.8% to Kshs 8.7 bn in Q1’2021, from Kshs 5.3 bn recorded in Q1’2020 with the effective tax rate increasing to 25.5% from 24.0% in Q1’2020.

Balance Sheet

- The balance sheet recorded an expansion as Total Assets increased by 53.9% to Kshs 1,066.4 bn, from Kshs 693.2 bn recorded in Q1’2020. This growth was largely driven by a 28.6% increase in the loan book to Kshs 487.7 bn, from Kshs 379.2 bn recorded in Q1’2020, coupled with 26.8% growth in Investment in government securities to Kshs 169.9 bn, from Kshs 142.4 bn recorded in Q1’2020. The remarkable expansion in the balance sheet is partly attributable to the 66.5% stake acquisition of Congolese lender, Banque Commerciale Du Congo (BCDC) in August 2020,
- Total liabilities rose by 60.5% to Kshs 926.0 bn, from Kshs 576.8 bn in Q1’2020, driven by a 58.2% increase in customer deposits to Kshs 789.9 bn, from Kshs 499.3 bn in Q1’2020. Key to note, the strong growth in customer deposits is mainly attributable to the acquisition of BCDC, with the subsidiary contributing Kshs 265.9 bn to the total deposits. Deposits per branch increased by 41.3% to Kshs 2.4 bn, from Kshs 1.7 bn in Q1’2020, with the number of branches increasing by 36 to 336 branches in Q1’2021, from 300 in Q1’2020, with Equity BCDC contributing 26 additional branches,
- The faster 58.2% growth in customer deposits as compared to the 28.6% growth in loans, led to a decline in the Loans to deposit ratio declined to 61.7% from 75.9% in Q1’2020,
- Gross Non-Performing Loans (NPLs) increased by 42.2% to Kshs 63.5 bn in Q1’2021, from Kshs 44.6 bn recorded in Q1’2020. The NPL ratio rose to 12.1% in Q1’2021, from 11.2% recorded in Q1’2020, attributable to the faster 42.2% growth in Gross Non-Performing Loans (NPLs), compared to the 30.8% increase in gross loans. The main sectors that contributed to the deterioration in asset quality were SMEs and micro enterprises sectors, which contributed the largest portion of the Non-Performing loans with NPL Ratios of 15.5% and 10.1%, respectively. The group’s Tanzania subsidiary also recorded a high NPL ratio of 33.7% in Q1’2021, with Equity Bank Kenya recording an NPL ratio of 11.5% in Q1’2021. With the general Loan Loss Provisions increasing by 82.4% to Kshs 27.5 bn, from Kshs 15.1 bn in Q1’2020, higher than the 42.2% rise in the Gross Non-Performing Loans, the NPL coverage improved to 55.5%, from 45.8% in Q1’2020, an indication of sufficient provisioning,
- Shareholders’ funds grew by 16.1% to Kshs 133.9 bn in Q1’2021, from Kshs 115.3 bn in Q1’2020, mainly supported by a 22.0% growth in retained earnings to Kshs 127.4 bn, from Kshs 104.4 bn in Q1’2020,

- Equity Group is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 14.2%, 3.7% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 18.0%, exceeding the statutory requirement by 3.5% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 14.3% while total capital to risk-weighted assets came in at 18.1%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.7%, and a Return on Average Equity (ROaE) of 18.9%.

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 40.0% to the group's total asset base. However, given the high NPL levels in the group's Tanzania subsidiary of 33.7%, the group will need to improve its credit assessment in the country to bring down the high NPL ratio. Cumulatively, the group's subsidiaries recorded a 6.9% growth in their Profit after Tax (PAT) to Kshs 1.6 bn, from Kshs 1,5 bn in Q1'2020, with the Tanzanian branch recording a y/y growth of 226.0% to a profit of Kshs 0.1 bn in Q1'2021, from a recorded loss of Kshs 0.1 bn in Q1'2020. Total assets in the bank's regional subsidiaries grew by 114.4% to Kshs 348.5 bn in Q1'2021, from Kshs 162.5 bn in Q1'2020, attributable to the acquisition of the Banque Commerciale Du Congo (BCDC). Lower efficiencies in the subsidiaries saw their cost structure contribution to the Group, improve to 50.0% in Q1'2021, from 36.0% in Q1'2020,
2. The Group's South Sudan subsidiary saw it's NPL ratio decline by 40.5% points to 0.3% in Q1'2021 from 40.8% recorded in Q1'2020. The improved asset quality is partly attributable to improved credit assessment,
3. Equity Group's recorded a remarkable increase in its balance sheet, as Total Assets increased by 53.9% to Kshs 1,066.4 bn, from Kshs 693.2 bn recorded in Q1'2020 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 320.0 bn worth of assets in Q1'2021 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 98.4% of all transactions of the bank being done on alternative channels, with mobile and internet transactions taking up 86.8% of all transactions, and agency banking contributing 6.5% of all transactions. In terms of the value of transactions, mobile and internet banking, branches and agency banking contributed 44.2%, 33.4% and 15.6%, 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, and,
5. The bank's asset quality deteriorated, as evidenced by the 1.0% points rise in the NPL ratio to 12.1% in Q1'2021, from 11.2% in Q1'2020. The main sectors that contributed to the deterioration in asset quality were SMEs and micro enterprises sectors, which contributed the largest portion of the Non-Performing loans with NPL Ratios of 15.5% and 10.1%, respectively. The group's Tanzania subsidiary also recorded a high NPL ratio of 33.7% in Q1'2021, with Equity Bank Kenya recording an NPL ratio of 11.5% in Q1'2021. The subsidiaries 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 60.6%, loan deposit ratio of 61.7% and a core capital to risk-weighted asset ratio of 14.2%.

Valuation Summary

- We are of the view that Equity Group is an "***Accumulate***" with a target price of Kshs 49.5 representing an upside of 15.0%, from the current price of Kshs 43.0 as of 28th May 2021,
- Equity Group is currently trading at a P/TBV of 1.3x and a P/E of 6.9x vs an industry average of 1.0x and 8.3x, respectively.