

Equity Group Holdings

Bloomberg: EQBNK KN Reuters: EQTY.NR



12th November 2021

We maintain our **HOLD** recommendation on Equity Group Holdings, with a target price of KES 51.43, representing a downside of 2.9% from the current market price of KES 53.25. The stock is currently trading at a trailing P/B of 1.5x and a forward P/B of 1/3x. We remain confident in the bank's rebound in performance against a backdrop of improving macroeconomic environment.

Key Considerations

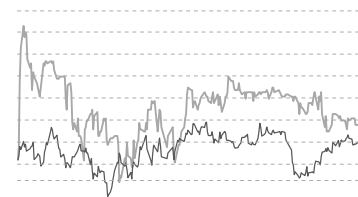
- Higher Net Interest Margin:** We forecast our NIMs to grow by 20bps y/y for the forecasted period. As the bank continues to mobilize cheaper deposits from alternative channels, we expect the cost of funds to remain flat at 2.7% with the rise in loan yields driven by loan book expansion (average loan/deposit ratio of 75%)
- Quality Earnings:** Non-funded income continues to be a key growth driver leveraging on i) alternative channels ii) launch of new products iii) strategic partnerships.
- Reduced Cost of Risk:** We expect the cost of risk forecast to remain within 2.0%-3.0% driven by growth in the performing book supported by economic recovery. We therefore see the overall asset quality improving.
- Regional Subsidiaries' Growth Momentum:** We expect regional subsidiaries to continue growing their group contribution to overall performance, with Equity BCDC being a key growth driver with the key focus being shifting from large corporate to MSME banking.

Key data	
Target Price (KES)	51.43
Market price (KES)- 11/11/21	53.00
Upside	(2.9%)
No. of shares (mn)	3,774
Market Cap (KESmn)	200.0
Free float	93.7%
Dividend yield	0%

Major Shareholders	% of shares
Norfininvest	11.99
James Mwangi	3.39
Britam Limited	3.15
Equity Nominees	2.88
Fortress Highlands Limited	2.68

YTD Change	45.0%
Min 52 weeks KES	55.00
Max 52 weeks KES	33.80

Price performance



Key Metrics	2017	2018	2019F	2020F	2021F	2022F	2023F	2024F	2025F
EPS	5.00	5.25	5.93	5.64	8.64	10.12	11.26	12.34	13.38
DPS	2.00	2.00	2.00	-	3.46	4.05	4.50	4.94	5.35
BVPS	24.48	24.93	29.34	35.02	40.21	46.28	53.03	60.44	68.46
P/B	2.15	2.12	1.80	1.51	1.31	1.14	0.99	0.87	0.77
P/E	10.55	10.05	8.90	9.36	6.11	5.21	4.68	4.27	3.94
Div Yield	3.8%	3.8%	3.8%	-	6.6%	7.7%	8.5%	9.4%	10.1%
ROaE	21.6%	21.1%	21.8%	17.0%	22.5%	23.4%	22.7%	21.8%	20.8%
RoAa	3.8%	3.6%	3.6%	2.5%	3.0%	3.1%	3.1%	3.1%	3.1%
C/I Ratio (excl. provisions)	51.9%	50.6%	51.0%	48.5%	42.9%	43.0%	43.4%	43.6%	43.8%

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3Q2021 FINANCIAL RESULTS

Equity Group after tax profit surged by 78.6% y/y to KES 26.8 billion for 3Q2021 (3Q2020: KES 15.0 billion) mainly attributed to growth in non-funded income, growth in subsidiaries' performance, decline in loan loss provisions and loan book expansion. ROaE increased to 24.0% from 16.9% in 3Q2020.

a) Net Interest Income up 23.3%

Net Interest Income grew by 23.3% y/y driven by growth in interest income growth of loans and government securities by 24.4% and 34.2% respectively. Yield on interest earning assets declined by 90bps y/y mainly due to faster growth in interest earning assets while cost of funds remained flat at 2.7% resulting in a 90bps decline in NIMs. We expect margins to improve with reallocation of assets from liquid securities to higher yield earning assets with support from lower cost of funds (alternative channels to continue driving the mobilization of cheap deposits).

b) Non-Funded Income Continues to Drive Growth

Non-funded income grew by 28.8% y/y to KES 31.9 billion driven by transactional income (+35.7%y/y in other fees and commission and +41.0% y/y in forex income). Contribution to total income now stands at 39.7% compared to Tier 1 banks contribution at 35.0%. With the introduction of new products such as pay with equity, targeting merchant payments, we expect a boost to non-funded income. We remain confident in the bank's revenue diversification strategy, with continued momentum in growing quality earnings.

c) Reduced Cost of Risk

Loan loss provisions declined by 65.2% y/y to KES 5.1 billion attributed to recoveries and write offs resulting in the cost of risk declining to 1.4% (3Q2020: 4.8%). NPL ratio declined to 8.9% from 10.7%, a declining trend from 11.3% in first quarter. Out of the KES 171 billion restructured loans, 68.9% had resumed payment at 3Q2021, KES 39 billion expected to resume payment in 12 months and KES 4 billion downgraded to Stage 3. We expect cost of risk to remain within management guidance of 1.5%-2.5%.

d) Rise in Operating Expenses

Total operating expenses (excluding provisions) increased by 26.8% y/y driven by 24.9% and 33.5% increase in staff costs and other expenses respectively. As a result, the cost to income ratio increased by 50bps to 48.1%. We attribute these mainly to acquisition related costs of Equity BCDC. The Kenyan subsidiary continues to exhibit a declining trend in its C/I ratio (39.8% in 3Q2021 from 47.0% in 3Q2018). In the medium term, we expect the group to continue reaping the benefits of its digitization strategy, implementing it across the different subsidiaries.

e) Regional Banking Subsidiaries Support Growth

Regional subsidiaries (except South Sudan) posted double digit growth in profitability, contributing 23.0% to overall profitability. Rwanda and Uganda recorded ROaE of 24.2% and 26.7% respectively against a cost of capital of 19.0%. Equity BCDC registered 125.0% growth in after tax profits and remains the key growth subsidiary given: i) low credit penetration ii) room for efficiency gains iii) shift in focus from corporate to SME banking iv) robust macro factors

EQUITY GROUP HOLDINGS FINANCIALS

Income Statement (KES Mn)	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Interest income	48,410	53,230	65,320	80,386	94,251	116,924	132,286	147,119	162,132
Interest expense	(10,841)	(11,808)	(14,740)	(18,616)	(22,498)	(25,625)	(27,991)	(30,323)	(32,853)
Net Interest income	37,569	41,422	50,580	61,770	71,753	91,299	104,295	116,796	129,279
Net fee income	16,342	15,271	11,573	10,101	15,524	17,442	19,661	21,945	24,643
Forex income	6,053	4,856	3,493	6,210	8,871	9,690	9,565	9,240	8,846
Total non-funded income	23,938	22,091	20,651	25,171	35,928	39,728	43,041	46,201	49,917
Total operating income	61,507	63,513	71,231	86,941	107,680	131,027	147,336	162,997	179,196
Credit impairment losses	(2,716)	(2,936)	(3,458)	(22,626)	(15,524)	(20,930)	(23,593)	(26,334)	(29,571)
Staff costs	(11,545)	(11,544)	(12,952)	(15,542)	(19,382)	(23,585)	(26,521)	(29,339)	(32,255)
Total operating expenses	(34,625)	(35,050)	(39,753)	(64,771)	(61,755)	(77,258)	(87,483)	(97,403)	(108,087)
Profit before tax	26,882	28,463	31,478	23,347	45,926	53,770	59,853	65,594	71,109
Income tax expense	(7,964)	(8,639)	(8,917)	(2,070)	(13,318)	(15,593)	(17,357)	(19,022)	(20,622)
Profit for the Year	18,918	19,824	22,561	21,277	32,607	38,176	42,496	46,572	50,488

Balance Sheet (KES Mn)	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Assets									
Loans and advances	279,092	297,227	366,440	477,847	584,953	662,783	754,974	851,480	956,139
Investment Securities	128,002	160,952	172,208	217,408	373,454	409,791	441,674	467,661	496,095
Property and equipment	10,865	10,276	11,031	15,904	17,341	17,383	17,486	17,565	17,576
Total Assets	524,465	573,384	673,682	1,015,093	1,177,522	1,294,025	1,417,956	1,548,399	1,698,987
Liabilities									
Customer deposits	373,143	422,758	482,752	740,800	887,099	968,981	1,062,745	1,155,019	1,263,731
Other borrowed funds	47,873	45,101	56,714	87,220	100,182	112,391	117,896	124,041	130,941
Other liabilities	9,832	10,343	12,865	32,896	35,484	33,914	31,882	34,651	37,912
Total Liabilities	431,323	478,427	561,905	876,452	1,025,784	1,119,380	1,217,814	1,320,314	1,440,609
Shareholders Equity	93,142	94,957	111,777	138,641	151,738	174,644	200,142	228,085	258,377
Total Equity and Liabilities	524,465	573,384	673,682	1,015,093	1,177,522	1,294,025	1,417,956	1,548,399	1,698,986

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Ratio Analysis									
Growth y/y %	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Assets	10.7%	9.3%	17.5%	50.7%	16.0%	9.9%	9.6%	9.2%	9.7%
Net Loans	4.9%	6.5%	23.3%	30.4%	22.4%	13.3%	13.9%	12.8%	12.3%
Deposits	10.7%	13.3%	14.2%	53.5%	19.7%	9.2%	9.7%	8.7%	9.4%
Non funded income	7.7%	-7.7%	-6.5%	21.9%	42.7%	10.6%	8.3%	7.3%	8.0%
Operating Expenses	-11.5%	1.2%	13.4%	62.9%	-4.7%	25.1%	13.2%	11.3%	11.0%
Net Profit	13.9%	4.8%	13.8%	-5.7%	53.3%	17.1%	11.3%	9.6%	8.4%
Margins									
	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Yield on interest earning assets	11.1%	11.1%	11.8%	10.3%	10.4%	10.5%	10.7%	10.9%	11.2%
Cost of funds	2.6%	2.5%	2.7%	2.9%	2.8%	2.7%	2.7%	2.7%	2.7%
Net Interest Margin (NIMs)	8.6%	8.7%	9.1%	7.4%	7.6%	7.8%	8.0%	8.2%	8.5%
Balance Sheet									
	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Gross Loans/Deposits	76.8%	74.9%	-	70.0%	70.0%	72.0%	74.0%	76.0%	78.0%
Net Loans/Deposits	74.8%	70.3%	75.9%	64.5%	65.9%	68.4%	71.0%	73.7%	75.7%
Loans/Assets	53.2%	51.8%	54.4%	47.1%	49.7%	51.2%	53.2%	55.0%	56.3%
Investment Securities/Deposits	34.3%	38.1%	35.7%	29.3%	42.1%	42.3%	41.6%	40.5%	39.3%
P&L									
	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Interest income/operating income	61.1%	65.2%	71.0%	71.0%	66.6%	69.7%	70.8%	71.7%	72.1%
Non interest income/operating income	38.9%	34.8%	29.0%	29.0%	33.4%	30.3%	29.2%	28.3%	27.9%
Staff costs/operating expenses	33.3%	32.9%	32.6%	24.0%	31.4%	30.5%	30.3%	30.1%	29.8%
C/I ratio (provisions excluded)	51.9%	50.6%	51.0%	48.5%	42.9%	43.0%	43.4%	43.6%	43.8%
C/I ratio (provisions included)	56.3%	55.2%	55.8%	74.5%	57.3%	59.0%	59.4%	59.8%	60.3%
Asset Quality									
	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Cost of risk	0.9%	0.9%	1.1%	6.1%	2.5%	3.0%	3.0%	3.0%	3.0%
NPLs/Gross Loans	6.4%	7.5%	8.5%	9.0%	12.0%	12.2%	11.5%	11.0%	10.5%

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Glossary of Terms

Net Interest Margin (NIM) - Net interest margin is a measure of the difference between interest paid and interest received, adjusted for the total amount of interest-generating assets held by the bank. It is calculated as: $\text{Net Interest Income} / \text{Average Interest Earning Assets}$

Basis points (bps) - one hundredth of a percentage i.e. $1.0\% = 100\text{bps}$ or $1\text{bps} = 0.01\%$

Target price - Analyst estimate of the fair value or intrinsic value of the company

Cost of Funds-This is the effective average interest rate paid on interest earning liabilities. It is calculated as $\text{Total Interest Expense} / \text{Average Interest Earning Liabilities}$

Loan Yield- This is the effective average interest rate received on average loans and advances. It is calculated as $\text{Interest on Loans and Advances} / \text{Average Loans and Advances}$

Cost of Risk - This ratio measures the amount of risk involved in lending. It is calculated as: $\text{Net Impairment Provisions} / \text{Average Gross Loans in the period}$

Non-performing loans-These are loans that have been classified as impaired. The CBK classifies loans into five categories i.e. Normal, Watch, Substandard, Doubtful and Loss depending on performance of the loan. The last three i.e. sub-standard, doubtful and loss are referred to as non-performing loans. Under IFRS, these classified as stage 3 loans.

Non-performing loans (NPL) Ratio - This is the proportion of NPLs in the loan book. It is calculated as $\text{Gross NPLs} / \text{Gross Loans}$

Non-funded/Non-Interest Income- This represents the income that is not classified as interest income.

Non-Funded/Non-Interest Income Ratio. This represents the proportion of total operating income that is not classified as interest income. It is calculated as $\text{Non-Interest Income} / \text{Total Operating Income}$

Composite market share (Market share Index) - This is a weighted composite index comprising of assets, deposits, capital size, number of deposit and loan accounts. The composite market share is used by CBK to classify banks into three groups:

- Tier 1(Large Size Bank); Composite market share of 5.0% and above
- Tier 2(Medium Size Bank); Composite market share of between 1.0% and 5.0%
- Tier 3(Small size Bank); Composite market share of less than 1.0%

Recommendation

BUY - Minimal risks to catalysts

SELL- Risks outweigh the catalysts

NEUTRAL - This is where the positives and negatives in a company almost balance out. You can accumulate for the long term.



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