AIB-AXYS AFRICA

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Earnings Note

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Equity Group Q3'23 Earnings Note

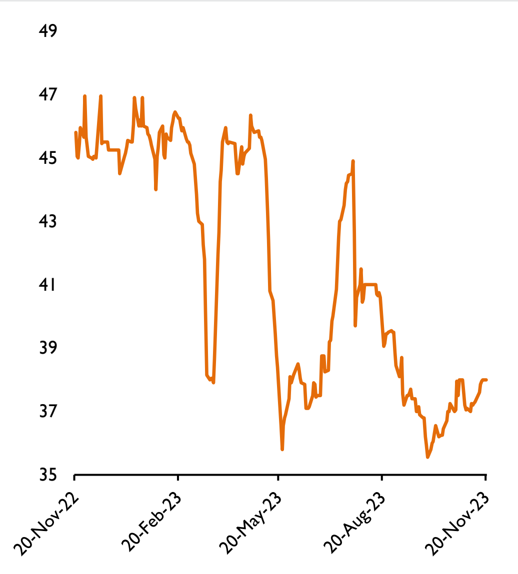
Recommendation:	Current Price:	Target Price:
BUY	KES 38.00	KES 56.11

Company details

Bloomberg Ticker	EQTY:KN
NSE Code:	EQT
Issued Shares (Bn)	3.77
52-week high (KES):	46.95
52-week Low (KES)	35.55

As at 20th November 2023

Equity Group Share Price Chart Last 12 Months



AIB-AXYS Research, NSE

Historical Price Performance

	1m	3m	6m	12m
Absolute	2.01%	-2.69%	-1.04%	-17.03%

AIB-AXYS Research, NSE

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Summary

- **Equity Group posted a mild 5.32% y/y increase in profit after tax (PAT) to KES 36.20Bn by close of Q3'23.** However, the trailing earnings per share (T-EPS) momentum declined 105bps to KES 12.23 over the quarter. The lender's bottom-line growth was driven by a 21.32% y/y increase in funded income to KES 72.6Bn and a 36.90% y/y increase in non-funded income to KES 57.8Bn. On the flipside, the strong revenue growth was watered down by a 46.35% y/y surge in operating expenses. The trailing ROaE and ROaA decelerated to 25.1% and 3.1% respectively in Q3'23. The Group's net interest margin widened 20bps y/y to 7.1% while the profit margin edged down y/y to 27.76%.
- **The Group's loan book expanded by 25.52% y/y to KES 845.92Bn faster than the 19.89% y/y growth in the customer deposits to KES 1.21Tn** leading to a 314bps climb in the loan-deposit ratio to 70.04% from 66.90% recorded in Q3'22. The group's loan book growth was buoyed by increased lending activity in DRC, South Sudan and Uganda while deposit mobilization was fastest in Tanzania and Rwanda businesses. We note also the proportion of transaction counts via mobile channels increased to 95% compared to 87% in 1H23, while the ratio of the value of mobile loans to branch loans disbursed clocked 42:58 – signaling higher average loan-ticket sizes in the branches. We also observed the share of foreign currency loans marginally climbing to 47.60% from 47.20% in Q3'22 signaling increased hard-currency demand and protracted exchange rate depreciation effects. We observed a 24.01% y/y balance sheet expansion to KES 1.69Tn – which we attribute to unwinding demographic dividends from its growing regional presence.

Key Highlights

- **Non-Funded Income Contribution Edges Closer to Parity** Non-funded income grew 36.90% y/y to KES 57.80Bn faster than the 21.32% y/y increase in net interest income to KES 72.80Bn. The surge in NFI was mainly driven by fast-growing forex trading income by 56.27% y/y underscoring the returns from increased cross-border trade finance activity. Consequently, the NII:NFI revenue mix shifted to 56:44 in favor of non-funded income from 59:41 recorded in Q3'22. Net Interest Margin (NIM) accelerated 20bps y/y to 7.1% driven by a faster increase in (yield on interest earnings assets (YIEA) compared to cost of funds. YIEA increased to 11.0% driven by loan up-pricing under the risk-based credit pricing and reinvestments into government securities at higher interest rates. Higher interest income from deposits with other banking institutions (+439.64% y/y) was reflective of tighter liquidity (average of 11.85% in Q3'23 vs 5.15% in Q3'22) among banking institutions in the Kenyan market. The Group's cost of funds increased by to 3.9% - stoked by rising interest rate environment and heightened sector-wide competition.
- **Asset Quality Concerns Persist :** Gross NPL's edged up by 83.45% y/y to KES 124.49Bn while the NPL ratio increased by 320bps y/y to 12.2%, lower than the latest industry average of 15.00%. The NPL coverage declined to 67% from 95% in Q3'22 driven by outsized impairment provisioning (+96.58% y/y) compared to growth in gross NPLs. On a quarterly basis, net NPLs increased by 30.84% to KES 58.06Bn of which KES 41.73Bn was from the Kenyan subsidiary (+46.12% q/q). We expect the asset quality to continue coming under pressure resulting from varied macroeconomic headwinds.

Other Performance Metrices

I. **DRC Records Strong Performance -** Equity BCDC in DRC remains a robust and profitable regional subsidiary by recording an impressive jump in PAT by 142.00% y/y to KES 11.40Bn with revenue increasing by 81.00% y/y to KES 39.20Bn. However, we observed a slower growth in deposits by 28.00% y/y to KES 428.00Bn compared to an impressive loan book growth by 71.00% y/y to KES 258.60Bn, the highest growth among the regional subsidiaries. Notably, the balance sheet increased by 31.00% y/y to KES 536.60Bn. We observed the subsidiary's ROaE improving to 28.10%, higher than the groups average of 25.10%. We noted a decline in cost to income ratio to 60.20% from 71.90% in Q3'22, lower than the groups ratio of 64.80%, pointing to higher investment efficiency. We anticipate that with continued investments in the subsidiary, operating expenses are likely to increase considering that the subsidiary is still in its expansion phase. We noted impressive PAT performance by the Tanzanian subsidiary (+136.00% y/y to KES 0.70Bn) and Rwanda (+46.00% y/y to KES 2.80Bn).

II. **Trade Finance Remains a Potent Growth Frontier -** In the past few years, EQTY has heightened its organization of trade financing, placing special emphasis on the DRC and other frontier markets. Additionally, the lender has solidified its position as the leading player in off-balance sheet finance within the Kenyan market. The results saw the increase of trade finance lending by 25.69% y/y to KES 45.50Bn while off-balance sheet trades and guarantees increased by 17.73% y/y to KES 183.90Bn. Consequently, the gross trade finance revenue climbed by 92.31% y/y to KES 7.50Bn. We expect sustained expansion in this area, driven by the ongoing regional economic recovery and increased trade among EAC countries.

III. **Increased Allocation to Government Securities -** We observed an increase in the allocation to government securities by 21.48% y/y to KES 445.18Bn which we attribute to the increase in yield on government securities to 11.50% from 10.30% in Q3'22. Consequently, there was a surge in treasury income by 35.64% y/y to KES 54.80Bn. Notably, with the exposure to Kenya Eurobonds, we witnessed a 56.89% y/y decline in the loss of FVOCI financial assets to KES(19.40)Bn from KES(45.00)Bn due to a mild ease in the sovereign yields. We anticipate the persistence of fair value losses in FY'23 due to the unfavorable outlook for the Kenyan macro environment, characterized by ongoing shilling depreciation and a diminished economic outlook. Nonetheless, considering that many of the sovereign bonds will mature post 2032, we believe interest-rate sensitivity remains elevated.

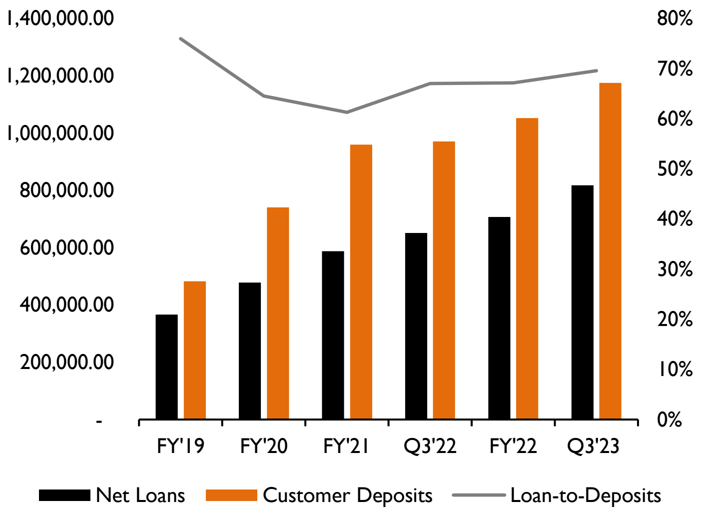
IV. **Rising Operating Costs Challenges Efficiency-** The Cost-to-Income ratio (excluding provisions) increased by 313bps y/y to 50.23% - mainly attributable to an increased staff costs and investments in maintenance of the digital banking infrastructure channels. The cost to assets ratio (excluding provisions) however, eased by 20bps y/y to 4.3% - implying efficiency of cost deployment. Management mulled an increase in loan-loss provisions by 96.58% y/y to KES 18.99Bn – signaling vigilance, as the lender moved to preserve asset quality.

Outlook – We maintain a positive outlook for FY'23, driven by the lender's focus on working capital lending, regional expansion in the DRC and Rwanda, and the fast growth of the emerging long-term and general insurance business. We expect digital lending channels to enhance economies of scale and support cost rationalization. We anticipate that growth in interest income will be driven by continued loan repricing and increased credit demand. We anticipate that growth in non-funded income will be driven by growth of trade financing networks and product cross-selling via digital channels. We expect the bank's lending to be supported by continued focus on SME credit and enhanced efforts tailored to specific sectors such as trade finance and infrastructure funding in the subsidiaries. However, challenges in the macro-economic environment may adversely impact overall asset quality.

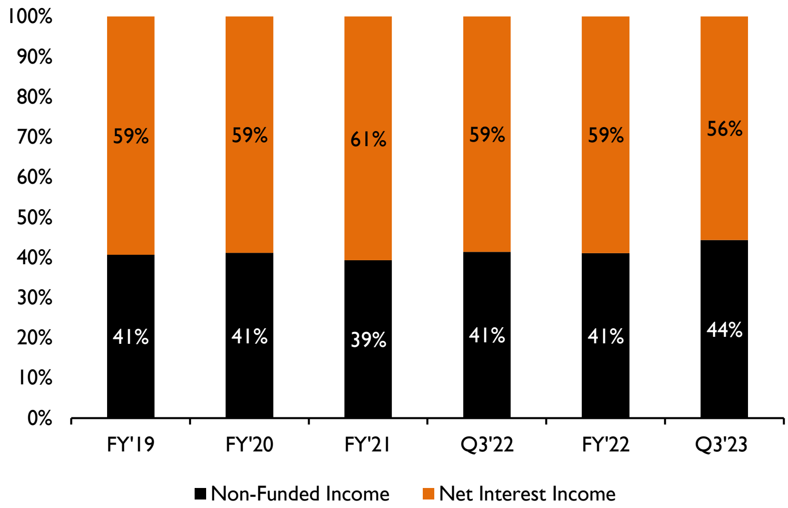
Valuation – The counter is currently trading at a P/B multiple of 0.74x and a P/E ratio of 3.11x. The counter closed yesterdays trading at KES 38.00, a YTD loss of 14.61%. We maintain our **BUY** recommendation on the counter with a target price of KES 56.10 representing an upside of 47.67% from yesterday's closing price.

Equity Group Q3'23 Earnings Charts

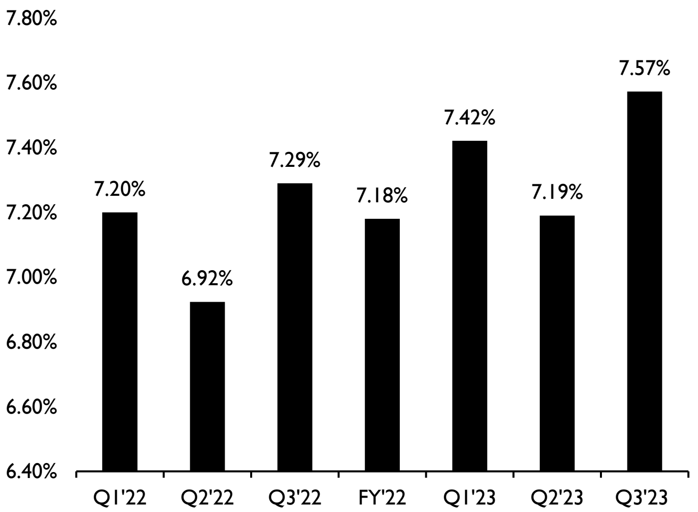
Graph 1: Fast Growth in Customer Deposits Drives Balance Sheet Expansion



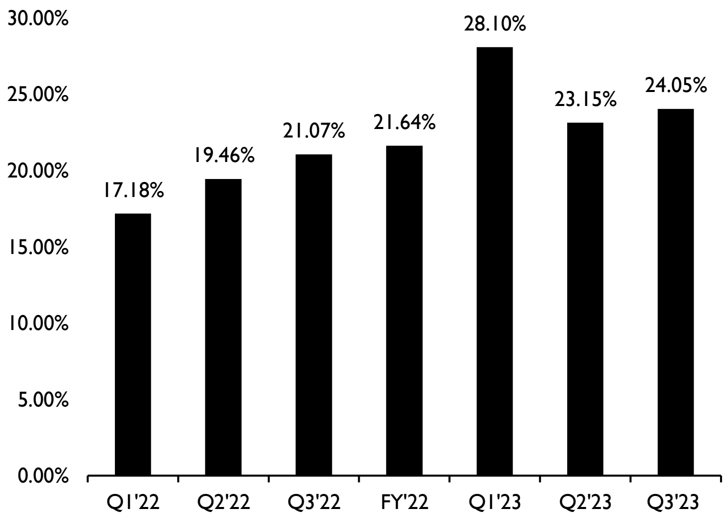
Graph 2: Non-funded Income Contribution Edges Closer to Parity



Graph 3: Widening Observed an Uptick in Net Interest Margins



Graph 4: Forex Income as a % of Net Income Remains Agile



Source: NSE, CBK, Company Fillings, AIB-AXYS Analyst Estimates

Financial Statement Summary

1. Statement of Profit and Loss

Income Statement	FY'19	FY'20	FY'21	Q3'22	FY'22	Q3'23	y/y % Change
Net Interest Income	44,982.36	55,148.79	68,810.97	59,843.76	85,999.04	72,604.58	21.32%
Net non-Interest Income	30,780.05	38,508.08	44,575.42	42,220.12	59,936.18	57,800.58	36.90%
Total Operating income	75,762.41	93,656.87	113,386.39	102,063.89	145,935.22	130,405.16	27.77%
Provision for Impairment	(5,302.57)	(26,631.27)	(5,844.71)	(9,660.50)	(15,414.32)	(18,990.47)	96.58%
Total Operating expenses	(44,284.98)	(72,664.47)	(61,505.37)	(57,738.91)	(86,091.44)	(84,498.34)	46.35%
Profit before tax	31,477.43	22,169.79	51,881.02	44,324.98	59,843.79	45,906.82	3.57%
Profit after tax	22,560.71	20,099.55	40,071.61	34,375.70	46,102.54	36,204.20	5.32%
Core EPS Annualized	5.98	5.33	10.62	11.39	11.90	12.23	5.32%

2. Statement of Financial Position

Balance Sheet	FY'19	FY'20	FY'21	Q3'22	FY'22	Q3'23	y/y % Change
Government Securities	138,572.96	217,407.89	394,101.45	366,454.88	393,983.86	445,177.02	21.48%
Loans and Advances	366,440.46	477,847.19	587,775.07	673,913.40	706,588.16	845,918.85	25.52%
Total Assets	**673,682.54**	**1,015,093.32**	**1,304,913.82**	**1,363,747.50**	**1,447,010.58**	**1,691,154.12**	24.01%
Customer Deposits	482,752.13	740,800.78	958,977.00	1,007,337.88	1,052,161.60	1,207,698.39	19.89%
Total Liabilities	561,905.88	876,452.52	1,128,722.45	1,209,671.28	1,264,799.30	1,497,945.29	23.83%
Total Equities and Liabilities	**673,682.54**	**1,015,093.32**	**1,304,913.82**	**1,363,747.50**	**1,447,010.58**	**1,691,154.12**	24.01%

3. Key Metrics

	Q1'22	Q2'22	Q3'22	FY'22	Q1'23	Q2'23	Q3'23
Growth Metrices (y/y)							
Loan book Growth	27.85%	28.86%	20.55%	20.21%	21.29%	25.61%	25.52%
Customer Deposits Growth	14.05%	18.45%	15.11%	9.72%	23.34%	21.04%	19.89%
PAT Growth	35.98%	36.16%	27.91%	15.05%	7.90%	7.77%	5.32%
Spreads Analysis							
Yield on Assets	9.88%	9.53%	10.14%	9.99%	10.53%	10.44%	11.24%
Cost of Funds	2.84%	2.83%	2.93%	2.93%	3.20%	3.35%	3.73%
Net Interest Margin	7.20%	6.92%	7.29%	7.18%	7.42%	7.19%	7.57%
ROaE	28.05%	30.48%	29.98%	29.05%	25.78%	27.85%	27.60%
ROaA	3.70%	3.80%	3.73%	3.35%	3.35%	3.22%	3.14%
Profit Margin	37.94%	37.21%	33.68%	31.59%	31.94%	31.77%	27.76%
Operating Effiency							
Cost of Income Less LLP	45.34%	46.68%	47.11%	48.43%	49.19%	49.01%	50.23%
Cost of Assets	1.21%	2.50%	3.77%	5.14%	1.40%	2.73%	4.29%
Loan to Deposit	69.21%	67.00%	66.90%	67.16%	68.07%	69.53%	70.04%
Asset Quality							
NPL	8.96%	8.85%	9.47%	8.41%	9.96%	11.20%	13.64%
NPL Coverage	66.03%	64.07%	62.95%	70.53%	62.05%	54.50%	53.37%
Cost of Risk	0.29%	0.63%	1.43%	2.18%	8.68%	8.56%	14.56%
Capital Adequency							
Core Capital/TRWA	13.90%	15.50%	16.10%	15.60%	15.50%	15.00%	15.20%
Total Capital /TRWA	18.70%	20.20%	20.70%	20.20%	19.80%	19.00%	19.20%
Liquidity	56.90%	53.20%	51.80%	52.10%	51.50%	51.10%	49.70%

******Key Metrices are on a Trailing basis***

Source: Company Fillings, AIB-AXYS Estimates

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