Cytonn INVESTMENTS

ABSA Bank Kenya Plc – FY'2022

17th March 2023

Below is a summary of ABSA Bank's FY'2022 performance;

Balance Sheet Items	FY'2021	FY'2022	y/y change
Government Securities	132.6	133.5	0.7%
Net Loans and Advances	234.2	283.6	21.1%
Total Assets	**428.7**	**477.2**	**11.3%**
Customer Deposits	268.7	303.8	13.0%
Deposits per Branch	3.2	3.7	14.4%
Total Liabilities	**372.2**	**413.6**	**11.1%**
Shareholder's Funds	**56.4**	**63.6**	**12.7%**

Balance sheet ratios	FY'2021	FY'2022	% point change
Loan to Deposit Ratio	87.2%	93.4%	6.2%
Return on average equity	21.1%	24.3%	3.2%
Return on average assets	2.7%	3.2%	0.5%

Income Statement Items	FY'2021	FY'2022	y/y change
Net Interest Income	25.3	32.3	27.9%
Net non-Interest Income	11.7	13.7	17.2%
Total Operating income	**36.9**	**46.0**	**24.6%**
Loan Loss provision	(4.7)	(6.5)	37.6%
Total Operating expenses	**(21.4)**	**(25.1)**	**17.6%**
Profit before tax	15.5	20.8	34.1%
Profit after tax	**10.9**	**14.6**	**34.2%**
Core EPS	**2.0**	**2.7**	**34.2%**

Income statement ratios	FY'2021	FY'2022	% point change
Yield from interest-earning assets	9.0%	10.3%	1.3%
Cost of funding	2.6%	2.9%	0.3%
Net Interest Spread	2.5%	2.8%	0.3%
Cost of risk	12.8%	14.1%	1.3%
Net Interest Margin	7.1%	8.2%	1.1%
Cost to Income	57.9%	54.7%	(3.2%)
Cost to income (Without LLPs)	45.1%	40.6%	(4.5%)
Cost to Assets	3.9%	3.9%	0.0%
Net Interest Income as % of operating income	68.4%	70.3%	1.9%
Non-Funded Income as a % of operating income	31.6%	29.7%	(1.9%)

Capital Adequacy Ratios	FY'2021	FY'2022	% Points change
Core Capital/Total Liabilities	17.9%	18.4%	0.5%
Minimum Statutory ratio	8.0%	8.0%	-
Excess	**9.9%**	**10.4%**	**0.5%**
Core Capital/Total Risk Weighted Assets	14.6%	14.6%	0.0%
Minimum Statutory ratio	10.5%	10.5%	-
Excess	**4.1%**	**4.1%**	**0.0%**
Total Capital/Total Risk Weighted Assets	17.1%	18.6%	1.5%
Minimum Statutory ratio	14.5%	14.5%	-
Excess	**2.6%**	**4.1%**	**1.5%**

Liquidity Ratio	38.3%	33.6%	(4.7%)
Minimum Statutory ratio	20.0%	20.0%	-
Excess	**18.3%**	**13.6%**	**(4.7%)**
Adjusted Core Capital/Total Liabilities	**18.0%**	**18.4%**	**0.4%**
Adjusted Core Capital/Total RWA	**14.7%**	**14.6%**	**(0.1%)**
Adjusted Total Capital/Total RWA	**17.2%**	**18.6%**	**1.4%**

Key FY'2022 highlights:

Absa Bank Kenya through Absa Asset Management Limited fully operationalized Asset Management Scheme involved in managing client funds for individual and institutional investors. The scheme has unit trust funds which include Money Market Fund for both Kenya Shillings and US dollars, Bond Fund, Balanced Fund and Equity Fund. Notably, according to the Capital Market Authority (CMA) Quarterly Statistical Bulletin-Q4'2022, Absa Unit Trust Scheme recorded the highest growth of 46.6%, with its AUM increasing to Kshs 1.5 bn, from Kshs 1.0 bn recorded in Q2'2022. The Scheme has recorded a significant growth from Kshs 0.3 bn recorded in Q1'2022 when they first published their Assets Under Management.

Income Statement

- Core earnings per share increased by 34.2% to Kshs 2.7 in FY'2022, from Kshs 2.0 in FY'2021, slightly higher than our projections of a 28.7% growth to Kshs 2.6 per share. The performance was driven by a 24.6% increase in total operating income to Kshs 46.0 bn, from Kshs 36.9 bn recorded in FY'2021. However, the growth was weighed down by the 17.6% increase in total operating expenses, to Kshs 25.1 bn, from Kshs 21.4 bn recorded in FY'2021,
- Total operating income rose by 24.6% to Kshs 46.0 bn, from Kshs 36.9 bn recorded in FY'2021 driven by a 27.9% increase in Net Interest Income (NII) to Kshs 32.3 bn, from Kshs 25.3 bn in FY'2021, coupled with a 17.2% gain in Non-Funded Income (NFI) to Kshs 13.7 bn, from Kshs 11.7 bn in FY'2021,
- Interest income grew by 27.5% to Kshs 40.9 bn in FY'2022, from Kshs 32.0 bn in FY'2021, mainly driven by a 32.8% increase in interest income from loans and advances to Kshs 30.7 bn, from Kshs 23.1 bn in FY'2021, coupled with a 13.6% increase in interest income from Government securities to Kshs 9.4 bn, from Kshs 8.3 bn in FY'2021. Consequently, the Yield on Interest-Earning Assets (YIEA) increased by 1.3% points to 10.3%, from 9.0% recorded in FY'2021, attributable to the faster 27.5% growth in trailing interest income which outpaced the 11.5% growth in the average Interest-Earning Assets (IEA). Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expenses increased by 25.9% to Kshs 8.5 bn, from Kshs 6.8 bn in FY'2021, following a 16.3% increase in interest expense on customer deposits to Kshs 7.0 bn, from Kshs 6.0 bn in FY'2021, coupled with 121.8% increase in interest expense on deposits and placements to Kshs 1.4 bn, from Kshs 0.7 bn in FY'2021. Consequently, the Cost of funds (COF) increased by 0.3% points to 2.9%, from 2.6% in FY'2021, owing to the faster 25.9% increase in the trailing interest expenses compared to the 15.9% growth in average interest-bearing liabilities. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) increased to 8.2% from 7.1% in FY'2021, attributable to the faster 32.4% increase in trailing net interest income, which outpaced the 11.5% growth in interest earning assets,
- Non-Funded Income (NFI) increased by 17.2% to Kshs 13.7 bn, from Kshs 11.7 bn in FY'2021, mainly driven by a 59.7% increase in Foreign Exchange trading income to Kshs 6.6 bn, from Kshs 4.2 bn in FY'2021, coupled with a 8.3% increase in other fees and income to Kshs 4.8 bn, from Kshs 4.4 bn in FY'2021. However, the growth was weighed down by a 20.2% declined in fees and commission on loan and advances to Kshs 1.4 bn, from Kshs 1.7 bn in FY'2021. Consequently, the bank's total fees and commissions marginally increased by 0.3% to Kshs 6.17 bn, from Kshs 6.16 bn in FY'2021. The revenue mix shifted to 70:30, funded

to non-funded income, from 68:32, funded to non-funded income recorded in FY’2021, attributable to the faster 27.9% increase in NII compared to the 17.2% increase in NFI,

- Total operating expenses increased by 17.6% to Kshs 25.1 bn in FY’2022, from Kshs 21.4 bn in FY’2021, mainly attributable to a 37.6% increase in Loan Loss Provisions (LLPs) to Kshs 6.5 bn, from Kshs 4.7 bn in FY’2021, coupled with an 11.2% increase in staff costs to Kshs 10.5 bn from Kshs 9.4 bn in FY’2021. Additionally, other operating expenses increased by 13.0% to Kshs 8.2 bn in FY’2022, from Kshs 7.2 bn in FY’2021. Notably, the increased provisioning level points towards more risk aversion and increased credit risk on the back of the deteriorating business environment as a result of increased inflationary pressures,
- Cost to Income Ratio (CIR) improved to 54.7%, from 57.9% in FY’2021, owing to 24.6% increase in total operating income, which outpaced the 17.6% growth in total operating expenses. Similarly, Without LLP the cost to income ratio improved significantly, declining by 4.5% points to 40.6%, from 45.1% in FY’2021, an indication of improved efficiency,
- Profit before tax and exceptional items increased by 34.1% to Kshs 20.8 bn in FY’2022, from Kshs 15.5 bn in FY’2021. Similarly, profit after tax increased by 34.2% to Kshs 14.6 bn in FY’2022, from Kshs 10.9 bn in FY’2021 with the effective tax rate declining to 30.0%, from 30.1% in FY’2021, and,
- ABSA Bank’s directors recommended a final dividend per share of Kshs 1.15 in FY’2022, adding to the Kshs 0.2 interim dividend paid in H1’2022, representing a dividend yield of 11.3%. The dividends recommended represent a 22.7% increase from dividend per share of Kshs 1.1 paid in FY’2021. Additionally, the dividend payout ratio decline to 50.3% in FY’2022, from 55.0% in FY’2021.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 11.3% to Kshs 477.2 bn in FY’2022, from Kshs 428.7 bn in FY’2021. This growth was largely driven by a 21.1% growth in the loan book to Kshs 283.6 bn, from Kshs 234.2 bn in FY’2021, coupled with a 0.7% increase in investments in government and other securities to Kshs 133.5 bn, from Kshs 132.6 bn in FY’2021. Additionally, placements in other banks increased by 64.8% to Kshs 5.0 bn, from Kshs 3.0 bn recorded in FY’2021,
- Total liabilities rose by 11.1% to Kshs 413.6 bn, from Kshs 372.2 bn in FY’2021, driven by a 13.0% increase in customer deposits to Kshs 303.8 bn, from Kshs 268.7 bn in FY’2021. Placements by other banking institutions also increased by 87.5% to Kshs 9.0 bn, from Kshs 4.8 bn in FY’2021. Deposits per branch rose by 14.4% to Kshs 3.7 bn, from Kshs 3.2 bn in FY’2021 with the number of branches decreasing by 1 to 83 from 84 in FY’2021,
- The faster 21.1% growth in loans compared to the 13.0% increase in customer deposits led to an increase in the loans to deposit ratio to 93.4%, from 87.2% recorded in FY’2021, indicating aggressive growth in lending,
- Gross Non-Performing Loans (NPLs) increased by 13.6% to Kshs 22.5 bn in FY’2022, from Kshs 19.8 bn recorded in FY’2021, while Gross loans increased by 20.9% to Kshs 301.7 bn, from Kshs 249.6 bn in FY’2021. Consequently, the asset quality improved with the NPL ratio declining to 7.5%, from 7.9% recorded in FY’2021. On the other hand, the NPL coverage increased to 80.5% in FY’2022, from 77.7% in FY’2021, owing to 92.1% increase in interest suspense to Kshs 4.8 bn, from Kshs 2.5 bn in FY’2021, coupled with 3.4% increase in General Loan Loss Provision to Kshs 13.3 bn, from Kshs 12.9 bn, relative to the 13.6% growth in Gross Non-Performing Loans (NPLs), an indication of increased provisioning,
- Shareholders’ funds increased by 12.7% to Kshs 63.6 bn, from Kshs 56.4 bn recorded in FY’2021. The increase is attributable to the 18.5% increase in Retained earnings to Kshs 56.0 bn, from Kshs 47.3 bn in FY’2021,
- ABSA Bank Kenya is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 14.6%, 4.1% points above the 10.5% statutory requirement. In addition, the total capital to risk-weighted

assets ratio was 18.6%, exceeding the 14.5% statutory requirement by 4.1% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 14.6% while total capital to risk-weighted assets came in at 18.6%, and,

- The bank currently has a Return on Average Assets (ROaA) of 3.2%, and a Return on Average Equity (ROaE) of 24.3%.

Key Take-Outs:

1. **Improvement in Asset Quality** - The bank's asset quality improved, with the NPL ratio declining by 0.4% points to 7.5% in FY'2022, from 7.9% in FY'2021, owing to the faster 20.9% growth in Gross Loans, as compared to the 13.6% increase in Gross Non-Performing Loans (NPLs). However, on q/q, the asset quality deteriorated as evidenced by the NPL ratio which rose by 0.9% points from 6.6% recorded in Q3'2022, mainly attributable to 12.4% increase in Gross Non-Performing Loans, coupled with 1.2% decline in Gross Loans,
2. **Increased Provisioning –** The Bank increased its Loans Loss Provision (LLPs) by 37.6% to Kshs 6.5 bn in FY'2022, from Kshs 4.7 bn recorded in FY'2021 aimed at mitigating increased credit risk on the back of the deteriorating business environment as a result of the high inflationary pressures. Additionally, the NPL coverage increased to 80.5% in FY'2022, from 77.7% in FY'2021, owing to 92.1% increase in interest suspense to Kshs 4.8 bn, from Kshs 2.5 bn in FY'2021, coupled with 3.4% increase in General Loan Loss Provision to Kshs 13.3 bn, from Kshs 12.9 bn, relative to the 13.6% growth in Gross Non-Performing Loans (NPLs). This points towards increased provisioning by the banks amidst high credit risk as a result of tough operating business environment,
3. **Improved deposit gathering capacity** – The Bank recorded double digit growth in deposits at 13.0% y/y growth in FY'2022 as compared to the 5.9% growth recorded in FY'2021. Consequently, the increased deposits have helped to bring down the loan to deposit to 93.4% in FY'2022, from a high of 103.0% in Q3'2022,
4. **Improved efficiency levels** – The Banks's cost to income ratio without LLP improved, declining by 4.5% to 40.6%, from 45.1% in FY'2021, an indication of improved efficiency, and,
5. **Improved Lending** – The Bank increased its lending in FY'2022 with Loans and advances recording a 21.1% growth, highlighting the Bank's aggressive lending despite the tough operating business environment.

Going forward, we expect the bank's growth to be driven by:

I. Diversification - The bank has continued to expand its product offerings aimed at growing Non-Funded income and reduce the bank's reliance on interest income. Notably, some of the new product offerings include business lines such Banc-assurance, Investment banking advisory, Risk Management products, fixed income brokerage and Asset Management which will continue growing the Non-Funded Income (NFI),

II. Digital transformation-The bank has capitalized on digitization with 52.0% of its processes having been automated as of December 2022. The continued digital transformation is expected to improve service delivery as well as enhance operational efficiency and in turn accelerate financial performance. Additionally, the uptake of "Timiza" which is a digital banking App, has also accelerated leading to higher Non-Interest Income, and,

III. Implementation of risk-based lending- ABSA Bank's loan book is expected continue growing as the lender will implement risk-based lending by June 2023. This is also expected to increase credit access especially by Micro, Small and Medium Enterprises (MSMEs) and in turn increase interest income.

Valuation Summary

- We are of the view that ABSA Bank Kenya is an "***BUY***" with a target price of Kshs 17.1, representing an upside of 42.3%, from the current price of Kshs 12.0 as of 17th March 2023, inclusive of a dividend yield of 11.3%,
- ABSA Bank Kenya is currently trading at a P/TBV of 1.0x and a P/E of 4.5x vs an industry average of 0.9x and 3.8x, respectively.