ABSA Bank Kenya Plc – FY'2020
26th March 2021

Valuation Summary

- We are of the view that ABSA Bank Kenya is an "**Accumulate**" with a target price of Kshs 9.8, representing an upside of 10.8%, from the current price of Kshs 8.9 as of 26th March 2021, inclusive of a dividend yield of 0.0%,
- ABSA Bank Kenya is currently trading at a P/TBV of 1.0x and a P/E of 11.6x vs an industry average of 0.9x and 7.5x, respectively.

Key Highlights FY'2020

- ABSA Bank restructured loans amounting to Kshs 62.0 bn during the year, representing 29.7% of its loan book which stood at Kshs 208.9 bn in FY'2020. This is in line with the CBK's emergency measures announced on March 18th 2020 to provide relief to borrowers during the pandemic. Personal Loans and Credit Cards contributed to the highest percentage of the 59,000 restructured loan accounts coming in at 60.0% and 37.0%, respectively.

Income Statement

- Core earnings per share declined by 44.2% to Kshs 0.8, from Kshs 1.4 in FY'2019, not in line with our expectation of a 22.6% decline to Kshs 1.1. The performance was driven by a 19.5% increase in total operating expenses, which grew faster than the 2.2% growth in total operating income. The variance in core earnings per share growth against our expectations was largely due to a 109.4% increase in exceptional items, largely associated with the rebranding process and the transition from Barclays to ABSA, which increased to Kshs 3.2 bn from Kshs 1.5 bn in FY'2019 coupled with the slower 0.9% increase in Net Interest Income compared to our projection of a 4.7% increase,
- Total operating income rose by 2.2% to Kshs 34.5 bn, from Kshs 33.8 bn in FY'2019. This was supported by a 5.2% rise in Non-Funded Income (NFI) to Kshs 11.1 bn, from Kshs 10.6 bn in FY'2019, coupled with a 0.9% increase in Net Interest Income (NII) to Kshs 23.4 bn, from Kshs 23.2 bn in FY'2019,
- Interest income rose by 1.3% to Kshs 31.4 bn, from Kshs 31.0 bn in FY'2019. This was driven by a 10.7% growth in interest income from government securities to Kshs 9.0 bn, from Kshs 8.1 bn in FY'2019. The growth in interest income was however weighed down by a 1.1% decline in Interest income from Loans and Advances to Kshs 22.3 bn, from Kshs 22.5 bn in FY'2019, as well as a 55.9% decline in interest income from placements to Kshs 0.2 bn, from Kshs 0.4 bn in FY'2019. The Yield on Interest-Earning Assets declined to 9.5%, from 10.4% in FY'2019, attributable to the faster 10.6% y/y increase in average interest earning assets to Kshs 331.1 bn, from Kshs 299.3 bn in FY'2019 that outpaced the 1.3% growth in trailing interest income. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expenses grew by 2.7% to Kshs 8.1 bn, from Kshs 7.9 bn in FY'2019, following a 51.2% rise in placement liabilities to Kshs 1.9 bn, from Kshs 1.3 bn in FY'2019. The increase in interest expenses was however mitigated by a 7.3% decline in interest expense on customer deposits to Kshs 6.0 bn, from Kshs 6.5 bn in FY'2019. Cost of funds, on the other hand, declined by 0.3% points to 3.2%, from 3.5% in FY'2019, owing to the faster 9.9% growth in average interest bearing liabilities, against a 2.7% increase in 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 7.1%, from 7.7% in FY'2019, owing to the faster 10.6% growth in average interest earning assets which outpaced the 0.9% growth in Net Interest Income (NII),

- Non-Funded Income (NFI) rose by 5.2% to Kshs 11.1 bn, from Kshs 10.6 bn in FY'2019. The growth was mainly driven by a 22.2% rise in foreign exchange trading income to Kshs 4.4 bn, from Kshs 3.6 bn in FY'2019. The growth was however weighed down a 10.8% decline in fees and commissions from loans to Kshs 1.3 bn, from Kshs 1.4 bn in FY'2019. Notably, total fees and commission income declined by 9.9% to Kshs 5.5 bn, from Kshs 6.1 bn in FY'2019, attributable to the waiver on fees on mobile banking transactions. As a result, the revenue mix adjusted to 68:32 from 69:31 recorded in FY'2019, funded to non-funded income, owing to the faster 5.2% growth in NFI, that outpaced the 1.3% growth in NII,
- Total operating expenses rose by 19.5% to Kshs 25.7 bn, from Kshs 21.5 bn in FY'2019, largely driven by a 114.9% increase in Loan Loss Provisions (LLP) to Kshs 9.0 bn in FY'2020, from Kshs 4.2 bn in FY'2019. The increased provisions is attributed to the bank adopting a cautious stance on the back of the expectations of increase in defaults due to the subdued operating environment. The rise in operating expenses was however mitigated by a 3.9% decline in staff costs to Kshs 9.8 bn in FY'2020, from Kshs 10.2 bn in FY'2019, coupled with a 3.4% decline in other operating expense to Kshs 6.9 bn, from Kshs 7.1 bn in FY'2019,
- The Cost to Income Ratio (CIR) deteriorated to 74.4%, from 63.6% in FY'2019, owing to the faster 19.5% rise in total operating expenses to Kshs 25.7 bn, from Kshs 21.5 bn in FY'2019, which outpaced the 2.2% growth in total operating income to Kshs 34.5 bn, from Kshs 33.8 bn in FY'2019. However, without LLP, the cost to income ratio improved to 48.2%, from 51.2% in FY'2019, an indication of improved efficiency,
- Profit before tax and exceptional items declined by 28.0% to Kshs 8.9 bn, from Kshs 12.3 bn in FY'2019. Profit after exceptional items before tax declined by 47.5% to Kshs 5.7 bn in FY'2020, from Kshs 10.8 bn in FY'2019. Profit after tax and exceptional items declined by 44.2% to Kshs 4.2 bn in FY'2020, from Kshs 7.5 bn in FY'2019, attributable to the costs incurred as part of the brand transition to ABSA which was finalized in 2020. The effective tax rate declined by 10.0% points to 16.8% from 26.8% in FY'2019, mainly attributable to the low corporate tax rate of 25.0% which was implemented by the government in order to cushion businesses against possible effects of COVID-19 Pandemic. Key to note, the low corporate tax rate was in effect between May 2020 and December 2020, and,
- Owing to the poor operating environment in FY'2020 that led to a 44.2% decline in the Profit after tax coupled with the need to preserve cash flows to caution against any further effects, the Board of Directors did not recommend the payment of dividends in FY'2020, as compared to the Kshs 1.1 paid out in FY'2019.

Balance Sheet

- The balance sheet recorded an expansion as total assets rose by 1.5% to Kshs 379.4 bn, from Kshs 374.0 bn in FY'2019. This growth was largely driven by an 7.2% growth in the loan book to Kshs 208.9 bn, from Kshs 194.9 bn in FY'2019, coupled with a 2.5% increase in government securities to Kshs 126.1 bn, from Kshs 123.0 bn in FY'2019,
- Total liabilities grew by 1.3% to Kshs 332.9 bn, from Kshs 328.8 bn in FY'2019, driven by a 6.7% increase in customer deposits to Kshs 253.6 bn, from Kshs 237.7 bn in FY'2019, coupled with a 13.5% increase in other liabilities to Kshs 75.2 bn, from Kshs 87.0 bn in FY'2019. Deposits per branch increased by 11.8% to Kshs 3.0 bn, from Kshs 2.7 bn in FY'2019, with the number of branches having reduced to 84 in FY'2020, from 88 in FY'2019,
- The faster 7.2% growth in loans, which outpaced the 6.7% growth in deposits led to a marginal increase in the loan to deposit ratio to 82.3%, from 82.0% recorded in FY'2019,
- Gross Non-Performing Loans (NPLs) increased by 26.5% to Kshs 17.1 bn in FY'2020, from Kshs 13.5 bn in FY'2019. The NPL ratio thus deteriorated to 7.7% in FY'2020, from 6.6% in FY'2019, owing to the faster 26.5% growth in gross NPLs, which outpaced the 7.7% growth in gross loans (after adding back interest suspense). General Loan Loss Provisions rose by 24.5% to Kshs 9.7 bn, from Kshs 7.8 bn in FY'2019,
- The NPL coverage however declined to 71.1% in FY'2020, from 77.0% in FY'2019, owing to the slower 24.5% increase in General Loan Loss Provisions, which was outpaced by the 26.5% growth in gross non-

performing loans. If the NPL Coverage remained at the 77.0% level recorded in FY'2019, we would have had an additional provisioning of Kshs 1.5 bn, which would have reduced the earnings per share to Kshs 0.5 from the Kshs 0.8 reported,

- Shareholders' funds increased by 2.9% to Kshs 46.5 bn in FY'2020, from Kshs 45.2 bn in FY'2019, driven by a 14.6% increase in retained earnings to Kshs 42.5 bn, from Kshs 37.1 bn in FY'2019,
- ABSA Bank Kenya is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 14.7%, 4.2% points above the 10.5% statutory requirement. In addition, the total capital to risk-weighted assets ratio was 17.5%, exceeding the 14.5% statutory requirement 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 17.6%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.1%, and a Return on Average Equity (ROaE) of 15.1%.

Key Take-Outs:

1. The Cost to Income Ratio (CIR) deteriorated to 74.4%, from 63.6% in FY'2019, attributable to the 114.9% increase in Loan Loss Provisions (LLP) to Kshs 9.0 bn in FY'2020, from Kshs 4.2 bn in FY'2019, as customers struggled to keep up with loan repayments due to a poor economic environment affecting persons and businesses that was occasioned by the COVID-19 pandemic,
2. The bank's asset quality deteriorated, with the NPL ratio increasing to 7.7% in FY'2020, from 6.6% in FY'2019, owing to the faster 26.5% growth in gross NPLs, which outpaced the 24.5% growth in gross loans (after adding back interest suspense). Notably, the lenders current NPL ratio of 7.7% is below the banking sector average of 14.1%, as of December 2020 and the bank's H1'2020 ratio of 8.8% mainly due to the improved business environment couple with an improved credit assessment metrics, and,
3. The bank recorded a relatively strong growth in its balance sheet, as deposits grew by 6.7% y/y, and were channeled to loans and advances, which grew, by 7.2% y/y, and government securities investments, which grew by 2.5%. The growth in interest earning assets helped support increased interest income revenue, despite the decline in yields of government securities.

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

I. Increased Channel diversification, which is likely to help the bank to continue improving its operational efficiency. The benefits of this are already being felt with 87.0% of all transactions happening outside the branch, as well as the "Timiza" which is a digital banking App, that is already recording accelerated growth, and consequently higher Non-Interest Revenue. This coupled with the expansion of its agent-banking network and product offerings such as Bancassurance and fixed income trading will see the bank expand its top-line revenue, going forward.

Below is a summary of the bank's performance:

Balance Sheet	FY'2019	FY'2020	y/y change	FY'2020e	Expected y/y change	Variance in Actual Growth vs. Expected
Government Securities	123.0	126.1	2.5%	137.0	11.4%	(8.9%)
Net Loans and Advances	194.9	208.9	7.2%	204.9	5.2%	2.0%
Total Assets	**374.0**	**379.4**	**1.5%**	**391.0**	**4.5%**	**(3.1%)**
Customer Deposits	237.7	253.6	6.7%	249.0	4.7%	1.9%
Total Liabilities	328.8	332.9	1.3%	340.9	3.7%	(2.4%)
Shareholder's Funds	**45.2**	**46.5**	**2.9%**	**50.1**	**10.9%**	**(8.0%)**

Balance sheet ratios	FY'2019	FY'2020	% y/y change
Loan to Deposit Ratio	82.0%	82.3%	0.3%
Return on average equity	16.7%	15.1%	(1.6%)
Return on average assets	2.1%	1.1%	(1.0%)

Income Statement	FY'2019	FY'2020	y/y change	FY'2020e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	23.2	23.4	0.9%	24.3	4.7%	(3.8%)
Net non-Interest Income	10.6	11.1	5.2%	11.3	6.6%	(1.4%)
Total Operating income	**33.8**	**34.5**	**2.2%**	**35.6**	**5.3%**	**(3.1%)**
Loan Loss provision	(4.2)	(9.0)	114.9%	(10.4)	146.5%	(31.6%)
Total Operating expenses	(21.5)	(25.7)	19.5%	(25.7)	19.4%	0.1%
Profit before tax	10.8	5.6	(47.5%)	8.0	(26.0%)	(21.5%)
Profit after tax	7.5	4.2	(44.2%)	5.8	(22.6%)	(21.6%)
Core EPS	**1.4**	**0.8**	**(44.2%)**	**1.1**	**(22.6%)**	**(21.6%)**

Income statement ratios	FY'2019	FY'2020	% y/y change
Yield from interest-earning assets	10.4%	9.5%	(0.9%)
Cost of funding	3.5%	3.2%	(0.3%)
Net Interest Margin	7.7%	7.1%	(0.6%)
Cost to Income	63.6%	74.4%	10.8%
Cost to Assets	4.6%	4.4%	(0.2%)
Net Interest Income as % of operating income	68.6%	67.7%	(0.9%)
Non-Funded Income as a % of operating income	31.4%	32.3%	0.9%

Capital Adequacy Ratios	FY'2019	FY'2020
Core Capital/Total Liabilities	16.3%	17.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**8.3%**	**9.3%**
Core Capital/Total Risk Weighted Assets	13.9%	14.7%
Minimum Statutory ratio	10.5%	10.5%
Excess	**3.4%**	**4.2%**
Total Capital/Total Risk Weighted Assets	16.6%	17.5%
Minimum Statutory ratio	14.5%	14.5%
Excess	**2.1%**	**3.0%**
Liquidity Ratio	39.8%	38.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	**19.8%**	**18.7%**
Adjusted Core Capital/Total Liabilities	**16.8%**	**17.5%**
Adjusted Core Capital/Total RWA	**14.3%**	**14.8%**
Adjusted Total Capital/Total RWA	**17.0%**	**17.6%**