ABSA Bank Kenya Plc – Q3'2021

26th November 2021

Below is a summary of ABSA Bank's Q3'2021 performance;

Balance Sheet Items	Q3'2020	Q3'2021	y/y change
Government Securities	134.0	126.6	(5.6%)
Net Loans and Advances	209.2	229.1	9.5%
Total Assets	**387.9**	**411.4**	**6.1%**
Customer Deposits	246.6	268.8	9.0%
Total Liabilities	343.2	356.8	3.9%
Shareholder's Funds	**44.6**	**54.6**	**22.4%**

Balance sheet ratios	Q3'2020	Q3'2021	% point change
Loan to Deposit Ratio	84.9%	85.2%	0.3%
Return on average equity	8.6%	21.1%	12.5%
Return on average assets	1.0%	2.6%	1.6%

Income Statement Items	Q3'2020	Q3'2021	y/y change
Net Interest Income	17.1	18.6	8.6%
Net non-Interest Income	8.3	8.7	5.2%
Total Operating income	**25.4**	**27.3**	**7.5%**
Loan Loss provision	(7.6)	(3.4)	(55.2%)
Total Operating expenses	(20.1)	(15.4)	(23.0%)
Profit before tax	**5.3**	**11.9**	122.4%
Profit after tax	**1.9**	**8.2**	328.3%
Core EPS	**0.4**	**1.5**	**328.3%**

Income statement ratios	Q3'2020	Q3'2021	% point change
Yield from interest-earning assets	9.5%	8.9%	(0.6%)
Cost of funding	3.2%	2.6%	(0.6%)
Net Interest Margin	7.1%	7.0%	(0.1%)
Cost to Income	79.0%	56.6%	(22.4%)
Cost to Assets	3.2%	2.9%	(0.3%)
Net Interest Income as % of operating income	67.3%	68.0%	0.7%
Non-Funded Income as a % of operating income	32.7%	32.0%	(0.7%)

Capital Adequacy Ratios	Q3'2020	Q3'2021
Core Capital/Total Liabilities	16.6%	17.9%
Minimum Statutory ratio	8.0%	8.0%
Excess	**8.6%**	**9.9%**
Core Capital/Total Risk Weighted Assets	13.7%	14.7%
Minimum Statutory ratio	10.5%	10.5%
Excess	**3.2%**	**4.2%**
Total Capital/Total Risk Weighted Assets	16.5%	17.3%
Minimum Statutory ratio	14.5%	14.5%
Excess	**2.0%**	**2.8%**
Liquidity Ratio	36.4%	39.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	**16.4%**	**19.7%**
Adjusted Core Capital/Total Liabilities	**16.7%**	**18.0%**

Adjusted Core Capital/Total RWA	**13.8%**	**14.8%**
Adjusted Total Capital/Total RWA	**16.6%**	**17.4%**

Income Statement

- Core earnings per share increased by 328.3% to Kshs 1.5 in Q3’2021, from Kshs 0.4 in Q3’2020, not in line with our expectations of a 265.3% increase to Kshs 1.3. The performance was driven by a 7.5% increase in total operating income to Kshs 27.3 bn, from Kshs 25.4 bn recorded in Q3’2020, coupled with a 23.0% decline in total operating expenses to Kshs 15.4 bn, from Kshs 20.1 bn recorded in Q3’2020. Notably, the improved earnings was supported by a 55.2% decline in Loan Loss Provision (LLP) to Kshs 3.4 bn in Q3’2021, from Kshs 7.6 bn in Q3’2020 on the back of an improved operating environment. Additionally, the bank did not incur any exceptional expenses during the quarter compared to the Kshs 1.9 bn expenses incurred in Q3’2020. The increase in the core earnings per share was higher than our projected increase of 265.3% as the lender had a faster 23.0% decline in total operating expenses, against our expectations of a 10.7% decrease to Kshs 17.9 bn,
- Total operating income rose by 7.5% to Kshs 27.3 bn, from Kshs 25.4 bn recorded in Q3’2020 driven by a 8.6% increase in Net Interest Income (NII) to Kshs 18.6 bn, from Kshs 17.1 bn in Q3’2020, coupled with a 5.2% gain in Non-Funded Income (NFI) to Kshs 8.7 bn, from Kshs 8.3 bn in Q3’2020,
- Interest income grew by 1.3% to Kshs 23.5 bn in Q3’2021, from Kshs 23.2 bn in Q3’2020, mainly driven by 3.9% increase in interest income from loans and advances to Kshs 17.0 bn, from Kshs 16.4 bn in Q3’2020, coupled with a 139.5% increase in interest income from deposits and placements with banking institutions to Kshs 0.4 bn, from Kshs 0.2 bn in Q3’2020. The growth in interest income was however weighed down by an 8.2% decline in interest income from government securities to Kshs 6.1 bn, from Kshs 6.7 bn in Q3’2020. The Yield on Interest-Earning Assets (YIEA) however declined to 8.9%, from 9.5% recorded in Q3’2020, attributable to the faster 7.3% y/y growth in average interest earning assets which 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 declined by 19.1% to Kshs 4.9 bn, from Kshs 6.1 bn in Q3’2020, following a 70.6% decline in interest expense on deposits and placement with banking institutions to Kshs 0.3 bn, from Kshs 1.2 bn in Q3’2020, coupled with a 6.4% decline in interest expense on customer deposits to Kshs 4.5 bn, from Kshs 4.8 bn in Q3’2020. Consequently, Cost of funds declined by 0.6% points to 2.6%, from 3.2% in Q3’2020, owing to a 12.7% decline in the trailing interest expense coupled with a 7.0% 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) declined to 7.0%, from 7.1% in Q3’2020 attributable to a faster 7.3% growth in average interest-earning assets, which outpaced the 6.0% increase in the trailing Net Interest Income (NII),
- Non-Funded Income (NFI) increased by 5.2% to Kshs 8.7 bn, from Kshs 8.3 bn in Q3’2020. The increase was mainly driven by a 37.8% increase in Fees and commissions on loans and advances to Kshs 1.3 bn, from Kshs 1.0 bn in Q3’2020 coupled with a 4.1% increase in other Fees and Commission income to Kshs 3.3 bn, from Kshs 3.2 bn in Q3’2020. The increase was however weighed down by a 3.4% decline in Foreign Exchange Trading income to Kshs 3.1 bn, from Kshs 3.2 bn in Q3’2020. Notably, the bank’s total fees and commissions increased by 11.9% to Kshs 4.6 bn, from Kshs 4.1 bn in Q3’2020 attributable to the expiry of the waiver on mobile banking fees. The revenue mix adjusted to 68:32 from 67:33 in Q3’2020, funded to non-funded income, owing to the faster 8.6% increase in NII compared to the 5.2% increase in NFI,
- Total operating expenses declined by 23.0% to Kshs 15.4 bn in Q3’2021, from Kshs 20.1 bn in Q3’2020, mainly attributable to an 8.6% decline in Staff Costs to Kshs 6.8 bn in Q3’2021, from Kshs 7.5 bn recorded

in Q3'2020. Additionally, Loan Loss Provisions (LLPs) declined by 55.2% to Kshs 3.4 bn in Q3'2021, from Kshs 7.6 bn recorded in Q3'2020 partly attributable to the improved business environment,

- Cost to Income Ratio (CIR) improved to 56.6%, from 79.0% in Q3'2020, owing to the 7.5% growth in total operating income coupled with the 23.0% decline in total operating expenses. The decline in total operating expense is largely attributable to the 55.2% decline in Loan Loss Provision (LLP) to Kshs 3.4 bn, from Kshs 7.6 bn in Q3'2021. Without LLP, the cost to income ratio improved as well to 44.1%, from 49.1% in Q3'2020, an indication of improved efficiency levels, and,
- Profit before tax and exceptional items increased by 122.4% to Kshs 11.9 bn in Q3'2021, from Kshs 5.3 bn in Q3'2020. Profit after tax increased by 328.3% to Kshs 8.2 bn in Q3'2021, from Kshs 1.9 bn recorded in Q3'2020 with the effective tax rate increasing to 30.6%, from 27.5% in Q3'2020. The increase in PAT is mainly attributable to the completion of the separation and transition process of Barclays Africa Group to Absa Group which saw the bank incur rebranding and separation costs of Kshs 1.9 bn incurred in Q3'2020.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 6.1% to Kshs 411.4 bn in Q3'2021, from Kshs 387.9 bn in Q3'2020. This growth was largely driven by a 9.5% growth in the loan book to Kshs 229.1 bn, from Kshs 209.2 bn in Q3'2020 coupled with a 6.3% increase in placements from banking institutions to Kshs 6.1 bn, from Kshs 5.8 bn in Q3'2020. The performance was however weighed down by a 5.6% decline in investments in government and other securities to Kshs 126.6 bn, from Kshs 134.0 bn recorded in Q3'2020,
- Total liabilities rose by 3.9% to Kshs 356.8 bn, from Kshs 343.2 bn in Q3'2020 driven by a 9.0% increase in customer deposits to Kshs 268.8 bn, from Kshs 246.6 bn in Q3'2020. On the other hand, placements held declined by 38.0% to Kshs 6.9 bn, from Kshs 11.1 bn in Q3'2020. Deposits per branch rose by 7.7% to Kshs 3.2 bn, from Kshs 2.9 bn in Q3'2020 with the number of branches having increased to 85 in Q3'2021, from 84 in Q3'2020,
- The faster 9.5% growth in loans compared to the 9.0% increase in customer deposits led to an increase in the loans to deposit ratio to 85.2%, from 84.9% recorded in Q3'2020,
- Gross Non-Performing Loans (NPLs) increased by 17.1% to Kshs 19.6 bn in Q3'2021, from Kshs 16.8 bn recorded in Q3'2020. Consequently, the NPL ratio rose to 8.1%, from 7.6% recorded in Q3'2020. The asset quality deterioration is attributable to the faster 17.1% growth in Gross Non-Performing Loans (NPLs), compared to the relatively slower 10.7% increase in gross loans. The sectors that contributed to this deterioration include manufacturing sector and wholesale and retail trade sector. The NPL coverage increased to 74.5% in Q3'2021, from 64.9% in Q3'2020, owing to the faster 45.1% increase in General Loan Loss Provisions, which outpaced the 17.1% growth in Gross Non-Performing Loans (NPLs),
- Shareholders' funds increased by 22.4% to Kshs 54.6 bn, from Kshs 44.6 bn recorded in Q3'2020. The increase can be attributed to the 26.5% increase in Retained earnings to Kshs 50.9 bn, from Kshs 40.2 bn in Q3'2020,
- 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 17.3%, exceeding the 14.5% statutory requirement by 2.8% 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 17.4%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.6%, and a Return on Average Equity (ROaE) of 21.1%.

Key Take-Outs:

1. The Cost to Income Ratio (CIR) improved to 56.6%, from 79.0% in Q3’2020, owing to the 7.5% growth in total operating income coupled with the 23.0% decline in total operating expenses. The decline in total operating expense is attributable to 55.2% decline in Loan Loss Provision (LLP) to Kshs 3.4 bn from Kshs 7.6 bn in Q3’2021. Without LLP, cost to income ratio improved as well to 44.1%, from 49.1% in Q3’2020, an indication of improved efficiency levels,
2. The bank’s asset quality deteriorated, with the NPL ratio increasing to 8.1% in Q3’2021, from 7.6% in Q3’2020, owing to the faster 17.1% growth in Gross Non-Performing Loans (NPLs), compared to the relatively slower 10.7% increase in gross loans. The sectors that contributed to this deterioration include manufacturing sector and wholesale and retail trade sector. The NPL coverage increased to 74.5% in Q3’2021, from 64.9% in Q3’2020, owing to the faster 45.1% increase in General Loan Loss Provisions, which outpaced the 17.1% growth in Gross Non-Performing Loans (NPLs), and,
3. Profit after tax increased by 328.3% to Kshs 8.2 bn in Q3’2021, from Kshs 1.9 bn recorded in Q3’2020 mainly attributable to the completion of the separation and transition process of Barclays Africa Group to Absa Group which saw the bank not inquiring exceptional expenses during the quarter compared to the 1.9 bn incurred in Q3’2020.

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 at FY’2020, 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.

Valuation Summary

- We are of the view that ABSA Bank Kenya is a “**Accumulate**” with a target price of Kshs 12.5, representing an upside of 14.0%, from the current price of Kshs 10.8 as of 26th November 2021,
- ABSA Bank Kenya is currently trading at a P/TBV of 1.1x and a P/E of 5.7x vs an industry average of 0.9x and 5.3x, respectively.