ABSA Bank Kenya Plc – FY'2021
18th March 2022

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

Balance Sheet Items	FY'2020	FY'2021	y/y change
Government Securities	126.1	132.6	5.2%
Net Loans and Advances	208.9	234.2	12.2%
Total Assets	**379.4**	**428.7**	**13.0%**
Customer Deposits	253.6	268.7	5.9%
Total Liabilities	332.9	372.2	11.8%
Shareholder's Funds	**46.5**	**56.4**	**21.4%**

Balance sheet ratios	FY'2020	FY'2021	% point change
Loan to Deposit Ratio	82.3%	87.2%	4.8%
Return on average equity	9.1%	21.1%	12.0%
Return on average assets	1.1%	2.7%	1.6%

Income Statement Items	FY'2020	FY'2021	y/y change
Net Interest Income	23.4	25.3	8.0%
Net non-Interest Income	11.1	11.7	4.7%
Total Operating income	**34.5**	**36.9**	**7.0%**
Loan Loss provision	(9.0)	(4.7)	(47.8%)
Total Operating expenses	(25.7)	(21.4)	(16.8%)
Profit before tax	**8.8**	**15.5**	75.7%
Profit after tax	**4.2**	**10.9**	161.2%
Core EPS	**0.8**	**2.0**	**161.2%**

Income statement ratios	FY'2020	FY'2021	% point change
Yield from interest-earning assets	9.5%	9.0%	(0.5%)
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	FY'2020	FY'2021
Core Capital/Total Liabilities	17.3%	17.9%
Minimum Statutory ratio	8.0%	8.0%
Excess	**9.3%**	**9.9%**
Core Capital/Total Risk Weighted Assets	14.7%	14.6%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.2%**	**4.1%**
Total Capital/Total Risk Weighted Assets	17.5%	17.1%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.0%**	**2.6%**
Liquidity Ratio	38.7%	38.3%
Minimum Statutory ratio	20.0%	20.0%
Excess	**18.7%**	**18.3%**
Adjusted Core Capital/Total Liabilities	**17.5%**	**18.0%**

Adjusted Core Capital/Total RWA	**14.8%**	**14.7%**
Adjusted Total Capital/Total RWA	**17.6%**	**17.2%**

Key Highlights in FY'2021

- In April 2021, ABSA Bank Kenya Plc launched an asset management arm, ABSA Asset Management Limited. The firm which is licensed by both the Retirement Benefits Authority and the Capital Markets Authority will offer Pensions and Fund management services. This continues the move by local lenders in growing their Non-Funded Income through pursuing of non-traditional banking activities, and,

- ABSA Bank Kenya Plc disclosed that 95.0% of the Kshs 59.0 bn restructured loans were performing as normal as at the end of 2021. The number of restructured loan accounts totaled 59,000, with personal loans and credit cards accounting for 60.0% and 37.0% of the restructured loans. The loan book restructuring was in line with the CBK's emergency measures for COVID-19 related loan restructuring which ran from 18th March 2020 to 2nd March 2021 in order to provide relief to borrowers during the pandemic.

Income Statement

- Core earnings per share increased by 161.2% to Kshs 2.0 in FY'2021, from Kshs 0.8 in FY'2020, not in line with our expectations of a 184.1% increase to Kshs 2.2. The performance was mainly attributable to the completion of the separation and transition process of Barclays Africa Group to Absa Group which saw the bank not incurring exceptional expenses during the year, compared to the Kshs 3.2 bn incurred in FY'2020. Additionally, total operating income increased by 7.0% to Kshs 36.9 bn, from Kshs 34.5 bn recorded in FY'2020, coupled with a 16.8% decline in total operating expenses to Kshs 21.4 bn, from Kshs 25.7 bn recorded in FY'2020. Notably, the improved earnings were supported by a 47.8% decline in Loan Loss Provision (LLP) to Kshs 4.7 bn in FY'2021, from Kshs 9.0 bn in FY'2020 on the back of an improved business operating environment. The variance in core earnings per share increase to Kshs 2.0 against our expectation of Kshs 2.2 was largely due to the 16.8% decline in the total operating expenses to Kshs 21.4 bn in FY'2021, from Kshs 25.7 bn in FY'2020, compared to our 22.1% projected decline,
- Total operating income rose by 7.0% to Kshs 36.9 bn, from Kshs 34.5 bn recorded in FY'2020 driven by a 8.0% increase in Net Interest Income (NII) to Kshs 25.3 bn, from Kshs 23.4 bn in FY'2020, coupled with a 4.7% gain in Non-Funded Income (NFI) to Kshs 11.7 bn, from Kshs 11.1 bn in FY'2020. Retail banking contributed to 54.0% of the revenue mix, while wholesale banking contributed to 46.0%,
- Interest income grew by 1.9% to Kshs 32.0 bn in FY'2021, from Kshs 31.4 bn in FY'2020, mainly driven by a 3.6% increase in interest income from loans and advances to Kshs 23.1 bn, from Kshs 22.3 bn in FY'2020, coupled with a 288.3% increase in interest income from deposits and placements with banking institutions to Kshs 0.6 bn, from Kshs 0.2 bn in FY'2020. The growth in interest income was however weighed down by a 7.5% decline in interest income from government securities to Kshs 8.3 bn, from Kshs 9.0 bn in FY'2020. The Yield on Interest-Earning Assets (YIEA) however declined to 9.0%, from 9.5% recorded in FY'2020, attributable to the faster 7.3% growth in average interest earning assets which outpaced the 1.9% 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 15.9% to Kshs 6.8 bn, from Kshs 8.1 bn in FY'2020, following a 65.5% decline in interest expense on deposits and placement with banking institutions to Kshs 0.7 bn, from Kshs 1.9 bn in FY'2020, coupled with a 28.6% decline in other interest expenses to Kshs 0.1 bn, from Kshs 0.2 bn in FY'2020. However, interest expense from customer deposits increased by 0.2% by Kshs 6.00 bn from Kshs 5.98 bn in FY'2020. The bank was able to mobilize cheaper deposits with the Cost of funds (COF) declining

by 0.6% points to 2.6%, from 3.2% in FY'2020, owing to the 15.9% decline in the trailing interest expense coupled with a 6.3% 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) remained unchanged at 7.0%,

- Non-Funded Income (NFI) increased by 4.7% to Kshs 11.7 bn, from Kshs 11.1 bn in FY'2020, mainly driven by a 37.7% increase in Fees and commissions on loans and advances to Kshs 1.7 bn, from Kshs 1.3 bn in FY'2020. The increase was however weighed down by a 6.4% decline in Foreign Exchange Trading income to Kshs 4.2 bn, from Kshs 4.5 bn in FY'2020. Notably, the bank's total fees and commissions increased by 11.6% to Kshs 6.2 bn, from Kshs 5.5 bn in FY'2020 attributable to the expiry of the waiver on mobile banking fees in December 2020, which had been put in place by the Central Bank of Kenya (CBK)'s measures to cushion the public from the effects of the pandemic. The revenue mix remained unchanged at 68:32, funded to non-funded income, similar to what was recorded in FY'2020,
- Total operating expenses declined by 16.8% to Kshs 21.4 bn in FY'2021, from Kshs 25.7 bn in FY'2020, mainly attributable to a 47.8% decline in Loan Loss Provisions (LLPs) to Kshs 4.7 bn in FY'2021, from Kshs 9.0 bn recorded in FY'2020. The reduced provisioning level was due to declining credit risk on the back of increased business activities in 2021 driven by the gradual economic recovery. Staff Costs declined by 3.3% to Kshs 9.4 bn in FY'2021, from Kshs 9.8 bn recorded in FY'2020,
- Cost to Income Ratio (CIR) improved to 57.9%, from 74.4% in FY'2020, owing to the 7.0% growth in total operating income coupled with the 16.8% decline in total operating expenses. The decline in total operating expense is largely attributable to the 47.8% decline in Loan Loss Provision (LLP) to Kshs 4.7 bn, from Kshs 9.0 bn in FY'2020. Without LLP, the cost to income ratio improved as well to 45.1%, from 48.2% in FY'2020, an indication of improved efficiency,
- Profit before tax and exceptional items increased by 75.7% to Kshs 15.5 bn in FY'2021, from Kshs 8.8 bn in FY'2020. Profit after tax increased by 161.2% to Kshs 10.9 bn in FY'2021, from Kshs 4.2 bn recorded in FY'2020 with the effective tax rate increasing to 30.1%, from 16.8% in FY'2020, attributable to the presence of exceptional items in 2020 which increased the profit before tax and exceptional items to Kshs 8.8 bn. 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 3.2 bn incurred in FY'2020, and,
- The Board of Directors recommended a final dividend per share of Kshs 1.1, subject to shareholders' approval. At the current price of Kshs 12.4, this translates to a dividend yield of 8.9%. The final dividend will be payable to shareholders in the share register as at book closure on 15th March 2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 13.0% to Kshs 428.7 bn in FY'2021, from Kshs 379.4 bn in FY'2020. This growth was largely driven by a 12.2% growth in the loan book to Kshs 234.2 bn, from Kshs 208.9 bn in FY'2020 coupled with a 5.2% increase in investments in government and other securities to Kshs 132.6 bn, from Kshs 126.1 bn in FY'2020. The performance was however weighed down by a 46.8% decline in placements in other banks to Kshs 3.0 bn, from Kshs 5.6 bn recorded in FY'2020,
- Total liabilities rose by 11.8% to Kshs 372.2 bn, from Kshs 332.9 bn in FY'2020, driven by a 5.9% increase in customer deposits to Kshs 268.7 bn, from Kshs 253.6 bn in FY'2020, coupled with a 18.0% increase in placements to Kshs 4.8 bn, from Kshs 4.1 bn in FY'2020. Deposits per branch rose by 5.9% to Kshs 3.2 bn, from Kshs 3.0 bn in FY'2020 with the number of branches remaining unchanged at 84,
- The faster 12.2% growth in loans compared to the 5.9% increase in customer deposits led to an increase in the loans to deposit ratio to 87.2%, from 82.3% recorded in FY'2020,

- Gross Non-Performing Loans (NPLs) increased by 15.9% to Kshs 19.8 bn in FY'2021, from Kshs 17.1 bn recorded in FY'2020. Consequently, the NPL ratio rose to 7.9%, from 7.7% recorded in FY'2020. The asset quality deterioration is attributable to the faster 15.9% growth in Gross Non-Performing Loans (NPLs), compared to the relatively slower 13.0% increase in gross loans. The sectors that contributed to this deterioration are the Hospitality and Tourism sector which recorded a slow recovery in 2021 due to the emergence of new strains which hampered economic growth. The NPL coverage increased to 77.7% in FY'2021, from 71.1% in FY'2020, owing to the faster 32.8% increase in General Loan Loss Provisions, which outpaced the 15.9% growth in Gross Non-Performing Loans (NPLs),
- Shareholders' funds increased by 21.4% to Kshs 56.4 bn, from Kshs 46.5 bn recorded in FY'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 FY'2020,
- 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 17.1%, exceeding the 14.5% statutory requirement by 2.6% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 14.7% while total capital to risk-weighted assets came in at 17.2%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.7%, and a Return on Average Equity (ROaE) of 21.1%.

Key Take-Outs:

1. Total operating income rose by 7.0% to Kshs 36.9 bn, from Kshs 34.5 bn recorded in FY'2020 driven by a 8.0% increase in Net Interest Income (NII) to Kshs 25.3 bn, from Kshs 23.4 bn in FY'2020, coupled with a 4.7% gain in Non-Funded Income (NFI) to Kshs 11.7 bn, from Kshs 11.1 bn in FY'2020. Retail banking contributed to 54.0% of the revenue mix, while wholesale banking contributed to 46.0%,
2. The Cost to Income Ratio (CIR) improved to 57.9%, from 74.4% in FY'2020, owing to the 7.0% growth in total operating income coupled with the 16.8% decline in total operating expenses. The decline in total operating expense is attributable to 47.8% decline in Loan Loss Provision (LLP) to Kshs 4.7 bn from Kshs 9.0 bn in FY'2020. Without LLP, cost to income ratio improved as well to 45.1%, from 48.2% in FY'2020, an indication of improved efficiency levels,
3. The bank's asset quality deteriorated, with the NPL ratio increasing to 7.9% in FY'2021, from 7.7% in FY'2020, owing to the faster 15.9% growth in Gross Non-Performing Loans (NPLs), compared to the relatively slower 13.0% increase in gross loans. The sectors that contributed to this deterioration are the Hospitality and Tourism sector which recorded a slow recovery in 2021 due to the emergence of new strains which hampered economic growth. However, the NPL ratio declined on a q/q basis to 7.9% from 8.1%, attributable to the eased business environment in the country following the lifting of COVID-19 containment measures such as lifting of the dusk to dawn curfew in Q4'2021. The NPL coverage increased to 77.7% in FY'2021, from 71.1% in FY'2020, owing to the faster 32.8% increase in General Loan Loss Provisions, which outpaced the 15.9% growth in Gross Non-Performing Loans (NPLs), and,
4. Profit after tax increased by 161.2% to Kshs 10.9 bn in FY'2021, from Kshs 8.2 bn recorded in FY'2020 mainly attributable to the completion of the separation and transition process of Barclays Africa Group to Absa Group which saw the bank not incurring exceptional expenses during the year compared to the Kshs 3.2 bn incurred in FY'2020.

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

I. Increased diversification, which is expected to reduce the bank's reliance on interest income as well as increasing the bottom line. The bank has continued to grow its product offerings to include business lines such as to Banc-assurance, Investment banking advisory and Asset Management which will continue growing the Non-Funded Income (NFI). The bank has also invested in its digital offerings especially after the onset of the COVID-19 pandemic. The benefits of this are already being felt with 90.0% of all transactions happening outside the branch as at FY'2021, coupled with uptake of "Timiza" which is a digital banking App, that is already recording accelerated growth, and consequently higher Non-Interest income. This coupled with the expansion of its agent-banking network and product offerings such as 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 an "***ACCUMULATE***" with a target price of Kshs 12.9, representing an upside of 14.7%, from the current price of Kshs 12.4 as of 18th March 2022, inclusive of a dividend yield of 9.0%,
- ABSA Bank Kenya is currently trading at a P/TBV of 1.2x and a P/E of 6.2x vs an industry average of 0.8x and 5.4x, respectively.