Cytonn INVESTMENTS

ABSA Bank Kenya Plc – Q1’2021

21st May 2021

Below is a summary of the ABSA Bank’s Q1’2021 performance:

Balance Sheet Items	Q1'2020	Q1'2021	y/y change
Government Securities	125.4	126.7	1.1%
Net Loans and Advances	203.0	218.3	7.5%
Total Assets	**381.5**	**384.1**	**0.7%**
Customer Deposits	238.7	257.1	7.7%
Total Liabilities	339.2	335.4	(1.1%)
Shareholder's Funds	**42.3**	**48.7**	**15.1%**

Balance sheet ratios	Q1'2020	Q1'2021	% point change
Loan to Deposit Ratio	85.0%	84.9%	(0.1%)
Return on average equity	17.0%	13.6%	(3.4%)
Return on average assets	2.1%	1.2%	(0.9%)

Income Statement Items	Q1'2020	Q1'2021	y/y change
Net Interest Income	5.6	6.0	5.9%
Net non-Interest Income	3.0	2.9	(3.9%)
Total Operating income	**8.6**	**8.8**	**2.5%**
Loan Loss provision	(1.1)	(1.4)	24.9%
Total Operating expenses	(5.2)	(5.4)	4.6%
Profit before tax	**3.4**	**3.4**	(0.7%)
Profit after tax	**2.0**	**2.4**	23.7%
Core EPS	**0.4**	**0.4**	**23.7%**

Income statement ratios	Q1'2020	Q1'2021	% point change
Yield from interest-earning assets	9.9%	9.3%	(0.6%)
Cost of funding	3.3%	3.0%	(0.2%)
Net Interest Margin	7.4%	7.0%	(0.4%)
Cost to Income	60.1%	61.3%	1.2%
Cost to Assets	1.1%	1.0%	(0.0%)
Net Interest Income as % of operating income	65.5%	67.7%	2.2%
Non-Funded Income as a % of operating income	34.5%	32.3%	(2.2%)

Capital Adequacy Ratios	Q1'2020	Q1'2021
Core Capital/Total Liabilities	16.6%	17.5%
Minimum Statutory ratio	8.0%	8.0%
Excess	**8.6%**	**9.5%**
Core Capital/Total Risk Weighted Assets	13.8%	14.4%
Minimum Statutory ratio	10.5%	10.5%
Excess	**3.3%**	**3.9%**
Total Capital/Total Risk Weighted Assets	16.5%	17.0%
Minimum Statutory ratio	14.5%	14.5%
Excess	**2.0%**	**2.5%**
Liquidity Ratio	37.9%	38.3%
Minimum Statutory ratio	20.0%	20.0%
Excess	**17.9%**	**18.3%**

Adjusted Core Capital/Total Liabilities	**17.0%**	**17.7%**
Adjusted Core Capital/Total RWA	**14.0%**	**14.5%**
Adjusted Total Capital/Total RWA	**16.7%**	**17.1%**

Key Highlights in Q1'2021

- During the Quarter, 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.

Income Statement

- Core earnings per share increased by 23.7% to Kshs 0.5, from Kshs 0.4 in Q1'2020, not in line with our expectation of a decline to Kshs 0.3. The performance was driven by a 5.9% increase in Net Interest Income to Kshs 6.0 bn, from Kshs 5.6 bn recorded in Q1'2020. The variance in core earnings per share growth against our expectations was largely due to the slower 4.6% increase in Total operating expenses to Kshs 5.4 bn, against our expectations of a 51.6% increase to Kshs 7.8 bn,
- Total operating income rose by 2.5% to Kshs 8.8 bn, from Kshs 8.6 bn in Q1'2020 supported by the 5.9% increase in Net Interest Income (NII) to Kshs 6.0 bn, from Kshs 5.6 bn in Q1'2020. The growth was however weighed down by a 3.9% decline in the Non-Funded Income (NFI) to Kshs 2.9 bn, from Kshs 3.0 bn in Q1'2020,
- Interest income declined by 0.3% to Kshs 7.60 bn, from Kshs 7.62 bn in Q1'2020, attributable to the 1.8% decline in interest income from government securities to Kshs 2.0 bn, from Kshs 2.1 bn in Q1'2020 and an 88.2% decline in interest income from placements to Kshs 12.5 mn, from Kshs 69.4 mn in Q1'2020. Interest income from Loans and Advances remained relatively unchanged at Kshs 5.5 bn. The Yield on Interest-Earning Assets declined to 9.3%, from 9.9% in Q1'2020, attributable to the faster 5.3% y/y increase in average interest earning assets to Kshs 87.0 bn, from Kshs 82.6 bn in Q1'2020 that outpaced the 0.6% 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 17.6% to Kshs 1.6 bn, from Kshs 2.0 bn in Q1'2020, following a 58.8% decline in placement liabilities to Kshs 0.2 bn, from Kshs 0.4 bn in Q1'2020, coupled with a 6.3% decline in interest expense on customer deposits to Kshs 1.4 bn, from Kshs 1.5 bn in Q1'2020. Cost of funds declined marginally by 0.3% points to 3.0%, from 3.3% in Q1'2020, owing an 8.0% growth in average interest bearing liabilities, against a 1.3% decline 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 7.0%, from 7.4% in Q1'2020, owing to the faster 5.3% growth in average interest earning assets which outpaced the 0.6% growth in Trailing Net Interest Income (NII),
- Non-Funded Income (NFI) declined by 3.9% to Kshs 2.9 bn, from Kshs 3.0 bn in Q1'2020 mainly driven by an 18.4% decrease in foreign exchange trading income to Kshs 0.9 bn, from Kshs 1.1 bn in Q1'2020. The decline was however mitigated by a 14.7% increase in fees and commissions from loans to Kshs 448.0 mn, from Kshs 390.7 mn in Q1'2020. Notably, total fees and commission income increased by 7.4% to Kshs 1.6 bn, from Kshs 1.5 bn in Q1'2020, attributable to the reversal of the waiver on fees on mobile banking transactions seen at the start of the year. As a result, the revenue mix adjusted to 68:32 from 69:31 recorded in Q1'2020, funded to non-funded income, owing to the 5.9% growth in NII, as compared to the 3.9% decline in NFI,
- Total operating expenses rose by 4.6% to Kshs 5.4 bn, from Kshs 5.2 bn in Q1'2020, largely driven by a 24.9% increase in Loan Loss Provisions (LLP) to Kshs 1.4 bn in Q1'2021, from Kshs 1.1 bn in Q1'2020. 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 7.6% decline in staff costs to Kshs 2.3 bn in Q1'2021, from Kshs 2.5 bn in Q1'2020,

- Cost to Income Ratio (CIR) deteriorated to 61.3%, from 60.1% in Q1'2020, owing to the faster 4.6% rise in total operating expenses to Kshs 5.4 bn, from Kshs 5.2 bn in Q1'2020, which outpaced the 2.5% growth in total operating income to Kshs 8.8 bn, from Kshs 8.6 bn in Q1'2020. However, without LLP, the cost to income ratio improved to 45.5%, from 47.1% in Q1'2020, an indication of improved efficiency, and,
- Profit before tax and exceptional items remained unchanged at Kshs 3.4 bn as was recorded in Q1'2020. Profit after exceptional items before tax increased by 18.4% to Kshs 3.4 bn in Q1'2021, from Kshs 2.9 bn in Q1'2020. Profit after tax and exceptional items increased by 23.7% to Kshs 2.4 bn in Q1'202021, from Kshs 2.0 bn in Q1'2020, with the effective tax rate increasing by 2.1% points to 29.0%, from 26.9% in Q1'2020.

Balance Sheet

- The balance sheet recorded an expansion as total assets rose by 0.7% to Kshs 384.1 bn, from Kshs 381.5 bn in Q1'2020. This growth was largely driven by a 7.5% growth in the loan book to Kshs 218.3 bn, from Kshs 203.0 bn in Q1'2020, coupled with a 1.1% increase in government securities to Kshs 126.7 bn, from Kshs 125.0 bn in Q1'2020. However, the growth was weighed down by a 30.8% decline in other assets to Kshs 17.6 bn from Kshs 25.5 bn in Q1'2020,
- Total liabilities declined by 1.1% to Kshs 335.4 bn, from Kshs 339.2 bn in Q1'2020, driven by a 21.3% decline in other liabilities to Kshs 75.2 bn from Kshs 95.6 bn in Q1'2020. On the other hand, customer deposits increased by 7.7% to Kshs 257.1 bn, from Kshs 238.7 bn in Q1'2020. Deposits per branch increased by 12.8% to Kshs 3.1 bn, from Kshs 2.7 bn in Q1'2020, with the number of branches having reduced to 84 in Q1'202021, from 88 in Q1'2020,
- The slower 7.5% growth in loans, which was outpaced by the 7.7% growth in deposits led to a marginal decline in the loan to deposit ratio to 84.9%, from 85.0% recorded in Q1'2020,
- Gross Non-Performing Loans (NPLs) remained relatively unchanged at Kshs 17.3 bn as was recorded in Q1'2020. The NPL ratio thus improved to 7.5% in Q1'2021, from 8.1% in Q1'2020, owing to the faster 7.8% growth in gross loans (after adding back interest suspense), which outpaced the flat growth in gross NPLs. General Loan Loss Provisions rose by 24.9% to Kshs 10.2 bn, from Kshs 8.8 bn in Q1'2020. The NPL coverage increased to 73.4% in Q1'2021, from 64.5% in Q1'2020, owing to a 24.9% increase in General Loan Loss Provisions, which outpaced the flat growth in gross non-performing loans.
- Shareholders' funds increased by 10.0% to Kshs 46.5 bn in Q1'202021, from Kshs 42.3 bn in Q1'2020, driven by a 15.1% increase in retained earnings to Kshs 44.9 bn, from Kshs 39.1 bn in Q1'2020,
- ABSA Bank Kenya is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 14.4%, 3.9% points above the 10.5% statutory requirement. In addition, the total capital to risk-weighted assets ratio was 17.0%, exceeding the 14.5% statutory requirement by 2.5% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 14.5%, while total capital to risk-weighted assets came in at 17.1%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.2%, and a Return on Average Equity (ROaE) of 13.6%.

Key Take-Outs:

1. The Cost to Income Ratio (CIR) deteriorated to 61.3%, from 60.1% in Q1'2020, attributable to the 24.9% increase in Loan Loss Provisions (LLP) to Kshs 1.4 bn in Q1'2021, from Kshs 1.1 bn in Q1'2020, as customers continued struggling to keep up with loan repayments due to a poor economic environment affecting persons and businesses that was occasioned by the COVID-19 pandemic, Key to note, this is the lowest

provision levels since the onset of the pandemic meaning that ABSA has strengthened its credit assessment methodologies improving borrower credit assessment,

2. The bank’s asset quality improved, with the NPL ratio declining to 7.5% in Q1’2021, from 8.1% in Q1’2020, owing to the faster 7.8% growth in gross loans (after adding back interest suspense), which outpaced the flat growth in gross NPLs. Notably, the lenders current NPL ratio of 7.5% is below the banking sector average of 14.6%, as of March 2021 and the bank’s FY’2020 ratio of 7.7% mainly due to the improving 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 7.7% y/y, and were channeled to loans and advances, which grew, by 7.5% y/y, and government securities investments, which grew by 1.1%. 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 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 10.4, representing an upside of 14.5%, from the current price of Kshs 9.1 as of 21st May 2021,
- ABSA Bank Kenya is currently trading at a P/TBV of 1.0x and a P/E of 10.7x vs an industry average of 0.9x and 7.2x, respectively.