ABSA Bank Kenya Plc – Q1'2023

02nd June 2023

Below is a summary of ABSA Bank's Q1'2023 performance;

Balance Sheet Items (Kshs bn)	Q1'2022	Q1'2023	y/y change
Government Securities	136.7	134.3	(1.8%)
Net Loans and Advances	242.7	310.0	27.7%
Total Assets	**438.5**	**514.6**	**17.4%**
Customer Deposits	269.5	310.8	15.3%
Deposits per Branch	3.2	3.7	15.3%
Total Liabilities	**379.3**	**446.6**	**17.7%**
Shareholder's Funds	**59.2**	**68.0**	**14.9%**

Balance sheet ratios	Q1'2022	Q1'2023	% point change
Loan to Deposit Ratio	90.0%	99.7%	9.7%
Return on average equity	21.2%	25.3%	4.1%
Return on average assets	2.8%	3.4%	0.6%

Income Statement Items (Kshs bn)	Q1'2022	Q1'2023	y/y change
Net Interest Income	6.9	9.4	36.0%
Net non-Interest Income	3.0	4.5	49.3%
Total Operating income	**9.9**	**13.9**	**40.0%**
Loan Loss provision	(1.2)	(2.4)	103.3%
Total Operating expenses	**(5.6)**	**(7.4)**	**32.8%**
Profit before tax	**4.3**	**6.4**	49.4%
Profit after tax	**3.0**	**4.5**	**50.7%**
Core EPS	**0.5**	**0.8**	**50.7%**

Income statement ratios	Q1'2022	Q1'2023	% point change
Yield from interest-earning assets	9.1%	10.6%	1.5%
Cost of funding	2.6%	3.1%	0.5%
Net Interest Spread	0.7%	0.9%	0.2%
Cost of risk	11.9%	17.3%	5.4%
Net Interest Margin	7.1%	8.3%	1.2%
Cost to Income	56.6%	53.7%	(2.9%)
Cost to income (Without LLPs)	44.6%	36.3%	(8.3%)
Cost to Assets	1.0%	1.0%	(0.0%)
Net Interest Income as % of operating income	69.5%	67.5%	(2.0%)
Non-Funded Income as a % of operating income	30.5%	32.5%	2.0%

Capital Adequacy Ratios	Q1'2022	Q1'2023	% points change
Core Capital/Total Liabilities	18.4%	18.6%	0.2%
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess	**10.4%**	**10.6%**	**0.2%**
Core Capital/Total Risk Weighted Assets	14.5%	14.1%	(0.4%)
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess	**4.0%**	**3.6%**	**(0.4%)**
Total Capital/Total Risk Weighted Assets	17.0%	18.1%	1.1%
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess	**2.5%**	**3.6%**	**1.1%**

Liquidity Ratio	36.7%	28.6%	(8.1%)
Minimum Statutory ratio	20.0%	20.0%	0.0%
Excess	**16.7%**	**8.6%**	**(8.1%)**
Adjusted Core Capital/Total Liabilities	**18.5%**	**18.7%**	**0.2%**
Adjusted Core Capital/Total RWA	**14.6%**	**14.2%**	**(0.4%)**
Adjusted Total Capital/Total RWA	**17.1%**	**18.2%**	**1.1%**

Income Statement

- Core earnings per share increased by 50.7% to Kshs 0.8 in Q1’2023, from Kshs 0.5 in Q1’2022, slightly higher than our projections of a 34.1% growth to Kshs 0.7 per share. The performance was driven by a 40.0% increase in total operating income to Kshs 13.9 bn, from Kshs 9.9 bn recorded in Q1’2022. However, the growth was weighed down by the 32.8% increase in total operating expenses, to Kshs 7.4 bn, from Kshs 5.6 bn recorded in Q1’2022,
- Total operating income rose by 40.0% to Kshs 13.9 bn, from Kshs 9.9 bn recorded in Q1’2022 driven by a 36.0% increase in Net Interest Income (NII) to Kshs 9.4 bn, from Kshs 6.9 bn in Q1’2022, coupled with a 49.3% gain in Non-Funded Income (NFI) to Kshs 4.5 bn, from Kshs 3.0 bn in Q1’2022,
- Interest income grew by 38.3% to Kshs 12.1 bn in Q1’2023, from Kshs 8.8 bn in Q1’2022, mainly driven by a 51.4% increase in interest income from loans and advances to Kshs 9.6 bn, from Kshs 6.3 bn in Q1’2022, coupled with a 9.2% increase in interest income from Government securities to Kshs 2.4 bn, from Kshs 2.2 bn in Q1’2023. However, Income from deposit and placement with banking institutions decline by 38.3% to Kshs 0.1 bn from Kshs 0.2 bn in Q1’2022. Consequently, the Yield on Interest-Earning Assets (YIEA) increased by 1.5% points to 10.6%, from 9.1% recorded in Q1’2022, attributable to the faster 33.1% growth in trailing interest income which outpaced the 13.9% 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 46.8% to Kshs 2.8 bn, from Kshs 1.9 bn in Q1’2022, following a 32.2% increase in interest expense on customer deposits to Kshs 2.1 bn, from Kshs 1.6 bn in Q1’2022, coupled with 139.4% increase in interest expense on deposits and placements to Kshs 0.6 bn, from Kshs 0.3 bn in Q1’2022. Consequently, the Cost of funds (COF) increased by 0.5% points to 3.1%, from 2.6% in Q1’2022, owing to the faster 33.8% increase in the trailing interest expenses compared to the 11.2% 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 8.3% from 7.1% in Q1’2022, attributable to the faster 20.5% increase in trailing net interest income, which outpaced the 13.9% growth in Average interest earning assets,
- Non-Funded Income (NFI) increased by 49.3% to Kshs 4.5 bn, from Kshs 3.0 bn in Q1’2022, mainly driven by a 79.9% increase in Foreign Exchange trading income to Kshs 2.2 bn, from Kshs 1.2 bn in Q1’2022, coupled with a 36.5% increase in other fees and income to Kshs 1.6 bn, from Kshs 1.2 bn in Q1’2022. Other income also increased by 22.1% to Kshs 0.4 bn, from Kshs 0.3 bn in Q1’2022. Consequently, the revenue mix shifted to 70:30, funded to non-funded income, from 67:33, funded to non-funded income recorded in Q1’2022, attributable to the faster 36.0% increase in NII compared to the 49.3% increase in NFI,
- Total operating expenses increased by 32.8% to Kshs 7.4 bn in Q1’2023, from Kshs 5.6 bn in Q1’2022, mainly attributable to a 103.3% increase in Loan Loss Provisions (LLPs) to Kshs 2.4 bn, from Kshs 1.2 bn in Q1’2022, coupled with an 18.8% increase in staff costs to Kshs 2.7 bn from Kshs 2.3 bn in Q1’2022. Additionally, other operating expenses increased by 8.9% to Kshs 2.4 bn in Q1’2023, from Kshs 2.2 bn in Q1’2022. 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 53.7%, from 56.6% in Q1'2022, owing to 40.0% increase in total operating income, which outpaced the 32.8% growth in total operating expenses. Similarly, Without LLP the cost to income ratio improved significantly, declining by 8.3% points to 36.3%, from 44.6% in Q1'2022, an indication of improved efficiency,
- Profit before tax and exceptional items increased by 49.4% to Kshs 6.4 bn in Q1'2023, from Kshs 4.3 bn in Q1'2022. Similarly, profit after tax increased by 50.7% to Kshs 4.5 bn in Q1'2023, from Kshs 3.0 bn in Q1'2022 with the effective tax rate declining to 30.7%, from 31.3% in Q1'2022, and,

<u>Balance Sheet</u>

- The balance sheet recorded an expansion as total assets grew by 17.4% to Kshs 514.6 bn in Q1'2023, from Kshs 438.5 bn in Q1'2022. This growth was largely driven by a 27.7% growth in the loan book to Kshs 310.0 bn, from Kshs 242.7 bn in Q1'2022. However, the growth was weighed down by a 1.8% decline in investments in government and other securities to Kshs 134.3 bn, from Kshs 136.7 bn in Q1'2022. Additionally, placements in other banks declined by 9.8% to Kshs 5.9 bn, from Kshs 6.5 bn recorded in Q1'2022,
- Total liabilities rose by 17.7% to Kshs 446.6 bn, from Kshs 379.3 bn in Q1'2022, driven by a 15.3% increase in customer deposits to Kshs 310.8 bn, from Kshs 269.5 bn in Q1'2022. Placements by other banking institutions also increased by 165.2% to Kshs 11.4 bn, from Kshs 4.3 bn in Q1'2022. Notably, the Bank had total borrowings of Kshs 4.2 bn in Q1'2023. Deposits per branch rose by 15.3% to Kshs 3.7 bn, from Kshs 3.2 bn in Q1'2022 with the number of branches remaining the same at 84 in Q1'2022,
- The faster 27.7% growth in loans compared to the 15.3% increase in customer deposits led to an increase in the loans to deposit ratio to 99.7%, from 90.0% recorded in Q1'2022, indicating aggressive lending by the Bank,
- Gross Non-Performing Loans (NPLs) increased significantly by 59.8% to Kshs 31.1 bn in Q1'2023, from Kshs 19.5 bn recorded in Q1'2022, while Gross loans increased by 28.1% to Kshs 329.9 bn, from Kshs 257.5 bn in Q1'2022. Consequently, the asset quality declined with the NPL ratio increasing to 9.4%, from 7.6% recorded in Q1'2022. Similarly, the NPL coverage decreased to 63.9% in Q1'2023, from 76.2% in Q1'2022, owing to the 59.8% growth in Gross Non-Performing Loans (NPLs) to Kshs 31.1 bn in Q1'2023, from Kshs 19.5 bn recorded in Q1'2022, which outpaced the increase in interest suspense to Kshs 4.5 bn, from Kshs 2.4 bn in Q1'2022, coupled with an increase in General Loan Loss Provision to Kshs 15.4 bn, from Kshs 12.5 bn,
- Shareholders' funds increased by 14.9% to Kshs 68.0 bn, from Kshs 59.2 bn recorded in Q1'2022. The increase was attributable to the 20.6% increase in Retained earnings to Kshs 60.4 bn, from Kshs 50.3 bn in Q1'2022,
- ABSA Bank Kenya is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 14.1%, 3.6% points above the 10.5% statutory requirement. In addition, the total capital to risk-weighted assets ratio was 18.1%, exceeding the 14.5% statutory requirement by 3.6% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 14.2% while total capital to risk-weighted assets came in at 18.7%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.4%, and a Return on Average Equity (ROaE) of 25.3%.

<u>Key Take-Outs:</u>

1. **Strong Earnings Growth –** The Core earnings per share increased by 50.7% to Kshs 0.8 in Q1'2023, from Kshs 0.5 in Q1'2022, driven by a 40.0% increase in total operating income to Kshs 13.9 bn, from Kshs 9.9 bn recorded in Q1'2022. The Bank's increase in total operating income was driven by a 36.0% increase in

Net Interest Income (NII) to Kshs 9.4 bn, from Kshs 6.9 bn in Q1’2022, coupled with a 49.3% gain in Non-Funded Income (NFI) to Kshs 4.5 bn, from Kshs 3.0 bn in Q1’2022,

2. **Deterioration in Asset Quality** - The bank’s asset quality deteriorated, with the NPL ratio increasing by 1.9% points to 9.4% in Q1’2023, from 7.6% in Q1’2022, owing to the faster 59.8% growth in Gross Non-Performing Loans, as compared to the 28.1% increase in Gross Loans
3. **Increased Provisioning –** The Bank increased its Loans Loss Provision (LLPs) by 103.3% to Kshs 2.4 bn in Q1’2023, from Kshs 1.2 bn recorded in Q1’2022 aimed at mitigating increased credit risk on the back of the deteriorating business environment as a result of the high inflationary pressures. The high credit risk is further evidenced by the 59.8% in Non-Performing Loans to Kshs 31.1 bn in Q1’2023, from Kshs 19.5 bn recorded in Q1’2022,
4. **Improved efficiency levels** – The Banks’s cost to income ratio without LLP improved, declining by 2.9% to 53.7%, from 56.6% in Q1’2022, owing to 40.0% increase in total operating income, which outpaced the 32.8% growth in total operating expenses. Similarly, Without LLP the cost to income ratio improved significantly, declining by 8.3% points to 36.3%, from 44.6% in Q1’2022, an indication of improved efficiency, and,
5. **Aggressive Lending** – The Bank increased its lending in Q1’2023 with Loans and advances recording a 27.7% growth, highlighting the Bank’s aggressive lending despite the tough operating business environment. Consequently, the loan to deposit ratio increased by 9.7% points to 99.7% from 90.0% in Q1’2022.

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 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 50.7%, from the current price of Kshs 11.4 as of 2nd June 2023, inclusive of a dividend yield of 11.6%,
- ABSA Bank Kenya is currently trading at a P/TBV of 0.8x and a P/E of 4.3x vs an industry average of 0.7x and 3.1x, respectively.