ABSA Bank Kenya Plc – Q3’2022

2nd December 2022

Below is a summary of ABSA Bank’s Q3’2022 performance;

Balance Sheet Items	Q3’2021	Q3’2022	y/y change
Government Securities	126.6	139.8	10.5%
Net Loans and Advances	229.1	289.4	26.4%
Total Assets	**411.4**	**481.3**	**17.0%**
Customer Deposits	268.8	281.1	4.6%
Deposits per Branch	3.2	3.4	7.1%
Total Liabilities	**356.8**	**421.1**	**18.0%**
Shareholder's Funds	**54.6**	**60.3**	**10.3%**

Balance sheet ratios	Q3’2021	Q3’2022	% point change
Loan to Deposit Ratio	85.2%	103.0%	17.8%
Return on average equity	21.1%	23.2%	2.1%
Return on average assets	2.6%	3.0%	0.4%

Income Statement Items	Q3’2021	Q3’2022	y/y change
Net Interest Income	18.6	23.3	25.3%
Net non-Interest Income	8.7	10.2	16.4%
Total Operating income	**27.3**	**33.4**	**22.5%**
Loan Loss provision	(3.4)	(5.0)	47.9%
Total Operating expenses	**(15.4)**	**(18.3)**	**18.5%**
Profit before tax	11.9	15.1	27.6%
Profit after tax	**8.2**	**10.7**	**30.1%**
Core EPS	**1.5**	**2.0**	**30.1%**

Income statement ratios	Q3’2021	Q3’2022	% point change
Yield from interest-earning assets	8.9%	9.6%	0.7%
Cost of funding	2.6%	2.8%	0.2%
Net Interest Spread	6.3%	6.8%	0.5%
Cost of risk	12.5%	15.0%	2.5%
Net Interest Margin	7.0%	7.6%	0.6%
Cost to Income	56.6%	54.7%	(1.9%)
Cost to income (Without LLPs)	44.1%	39.7%	(4.4%)
Cost to Assets	2.9%	2.8%	(0.1%)
Net Interest Income as % of operating income	68.0%	69.6%	1.6%
Non-Funded Income as a % of operating income	32.0%	30.4%	(1.6%)

Capital Adequacy Ratios	Q3’2021	Q3’2022	% Points change
Core Capital/Total Liabilities	17.9%	18.8%	0.9%
Minimum Statutory ratio	8.0%	8.0%	
Excess	**9.9%**	**10.8%**	**0.9%**
Core Capital/Total Risk Weighted Assets	14.7%	13.8%	(0.9%)
Minimum Statutory ratio	10.5%	10.5%	
Excess	**4.2%**	**3.3%**	**(0.9%)**
Total Capital/Total Risk Weighted Assets	17.3%	16.2%	(1.1%)
Minimum Statutory ratio	14.5%	14.5%	
Excess	**2.8%**	**1.7%**	**(1.1%)**

Liquidity Ratio	39.7%	25.8%	(13.9%)
Minimum Statutory ratio	20.0%	20.0%	
Excess	**19.7%**	**5.8%**	**(13.9%)**
Adjusted Core Capital/Total Liabilities	**18.0%**	**18.9%**	**0.9%**
Adjusted Core Capital/Total RWA	**14.8%**	**13.9%**	**(0.9%)**
Adjusted Total Capital/Total RWA	**17.4%**	**16.3%**	**(1.1%)**

Income Statement

- Core earnings per share increased by 30.1% to Kshs 2.0 in Q3’2022, from Kshs 1.5 in Q3’2021, higher than our projections of a 18.2% growth to Kshs 1.8. The performance was driven by a 22.5% increase in total operating income to Kshs 33.4 bn, from Kshs 27.3 bn recorded in Q3’2021. However, the growth was weighed down by the 18.5% increase in total operating expenses, to Kshs 18.3 bn, from Kshs 15.4 bn recorded in Q3’2021,
- Total operating income rose by 22.5% to Kshs 33.4 bn, from Kshs 27.3 bn recorded in Q3’2021 driven by a 25.3% increase in Net Interest Income (NII) to Kshs 23.3 bn, from Kshs 18.6 bn in Q3’2021, coupled with a 16.4% gain in Non-Funded Income (NFI) to Kshs 10.2 bn, from Kshs 8.7 bn in Q3’2021,
- Interest income grew by 24.7% to Kshs 29.3 bn in Q3’2022, from Kshs 23.5 bn in Q3’2021, mainly driven by a 27.8% increase in interest income from loans and advances to Kshs 21.7 bn, from Kshs 17.0 bn in Q3’2021, coupled with a 13.7% increase in interest income from Government securities to Kshs 7.0 bn, from Kshs 6.1 bn in Q3’2021. Consequently, the Yield on Interest-Earning Assets (YIEA) increased to 9.6%, from 8.9% recorded in Q3’2021, attributable to the faster 19.2% growth in trailing interest income which outpaced the 11.4% 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 22.4% to Kshs 6.1 bn, from Kshs 4.9 bn in Q3’2021, following a 11.8% increase in interest expense on customer deposits to Kshs 5.0 bn, from Kshs 4.5 bn in Q3’2021, coupled with 172.6% increase in interest expense on deposits and placements to Kshs 0.9 bn, from Kshs 0.3 bn in Q3’2021. Consequently, the Cost of funds (COF) increased by 0.2% points to 2.8%, from 2.6% in Q3’2021, owing to the faster 14.5% increase in the trailing interest expenses compared to the 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) increased to 7.6% from 7.0% in Q3’2021, attributable to the faster 20.5% increase in trailing net interest income, which outpaced the 11.4% growth in interest earning assets,
- Non-Funded Income (NFI) increased by 16.4% to Kshs 10.2 bn, from Kshs 8.7 bn in Q3’2021, mainly driven by a 60.0% increase in Foreign Exchange trading income to Kshs 5.0 bn, from Kshs 3.1 bn in Q3’2021, coupled with a 7.0% increase in other fees and income to Kshs 3.5 bn, from Kshs 3.3 bn in Q3’2021. However, the bank’s total fees and commissions declined by 1.2% to Kshs 4.56 bn, from Kshs 4.62 bn in Q3’2021. The revenue mix shifted to 70:30, funded to non-funded income, from 68:32, funded to non-funded income recorded in Q3’2021, attributable to the faster 25.3% increase in NII compared to the 16.4% increase in NFI,
- Total operating expenses increased by 18.5% to Kshs 18.3 bn in Q3’2022, from Kshs 15.4 bn in Q3’2021, mainly attributable to a 47.9% increase in Loan Loss Provisions (LLPs) to Kshs 5.0 bn, from Kshs 3.4 bn in Q3’2021, coupled with an 8.7% increase in staff costs to Kshs 7.4 bn from Kshs 6.8 bn in Q3’2021. 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 54.7%, from 56.6% in Q3’2021, owing to 22.5% increase in total operating income, which outpaced the 18.5% growth in total operating expenses. Similarly, Without LLP

the cost to income ratio improved significantly, declining by 4.4% points to 39.7%, from 44.1% in Q3’2021, an indication of improved efficiency, and,

- Profit before tax and exceptional items increased by 27.6% to Kshs 15.1 bn in Q3’2022, from Kshs 11.9 bn in Q3’2021. Similarly, profit after tax increased by 30.1% to Kshs 10.7 bn in Q3’2022, from Kshs 8.2 bn in Q3’2021 with the effective tax rate declining to 29.2%, from 30.6% in Q3’2021.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 17.0% to Kshs 481.3 bn in Q3’2022, from Kshs 411.4 bn in Q3’2021. This growth was largely driven by a 26.4% growth in the loan book to Kshs 289.4 bn, from Kshs 229.1 bn in Q3’2021, coupled with a 10.5% increase in investments in government and other securities to Kshs 139.8 bn, from Kshs 126.6 bn in Q3’2021. However, the growth was weighed down by 82.2% decline in placements in other banks to Kshs 1.1 bn, from Kshs 6.1 bn recorded in Q3’2021,
- Total liabilities rose by 18.1% to Kshs 421.3 bn, from Kshs 356.8 bn in Q3’2021, driven by a 4.6% increase in customer deposits to Kshs 281.1 bn, from Kshs 268.8 bn in Q3’2021. Placements by other banking institutions also increased by 29.9% to Kshs 8.9 bn, from Kshs 6.9 bn in Q3’2021. Deposits per branch rose by 7.1% to Kshs 3.4 bn, from Kshs 3.2 bn in Q3’2021 with the number of branches decreasing by 2 to 83 from 85 in Q3’2021,
- The faster 26.4% growth in loans compared to the 4.6% increase in customer deposits led to an increase in the loans to deposit ratio to 103.0%, from 85.2% recorded in Q3’2021. Key to note, this is the highest loan to deposit ratio the bank has recorded since FY’2016, mainly driven by the aggressive growth in lending as compared to a sustained single digit growth in deposits,
- Gross Non-Performing Loans (NPLs) increased by 2.0% to Kshs 20.0 bn in Q3’2022, from Kshs 19.6 bn recorded in Q3’2021, while Gross loans increased by 25.3% to Kshs 305.5 bn, from Kshs 243.7 bn in Q3’2021. Consequently, the asset quality improved with the NPL ratio declining to 6.6%, from 8.1% recorded in Q3’2021. On the other hand, the NPL coverage increased to 80.0% in Q3’2022, from 74.5% in Q3’2021, owing to the faster 10.3% increase in General Loan Loss Provisions, which outpaced the 2.0% growth in Gross Non-Performing Loans (NPLs), an indication of increased provisioning,
- Shareholders’ funds increased by 10.3% to Kshs 60.3 bn, from Kshs 54.6 bn recorded in Q3’2021. The increase is attributable to the 14.7% increase in Retained earnings to Kshs 58.3 bn, from Kshs 50.9 bn in Q3’2021,
- ABSA Bank Kenya is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 13.8%, 3.3% points above the 10.5% statutory requirement. In addition, the total capital to risk-weighted assets ratio was 16.2%, exceeding the 14.5% statutory requirement by 1.7% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 13.9% while total capital to risk-weighted assets came in at 16.3%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.0%, and a Return on Average Equity (ROaE) of 23.2%.

Key Take-Outs:

1. **Improvement in Asset Quality** - The bank’s asset quality improved, with the NPL ratio declining by 1.5% points to 6.6% in Q3’2022, from 8.1% in Q3’2021, owing to the faster 25.3% growth in Gross Loans, as compared to the 2.0% increase in Gross Non-Performing Loans (NPLs). Key to note, the NPL ratio also declined by 0.6% points from 7.1% recorded in H1’2022, mainly attributable to the Bank’s credit management strategies which include restructuring of non-performing loans, and,
2. **Increased Provisioning –** The Bank increased its Loans Loss Provision (LLPs) by 47.9% to Kshs 5.0 bn in Q3’2022, from Kshs 3.4 bn recorded in Q3’2021 aimed at mitigating increased credit risk on the back of

the deteriorating business environment as a result of the high inflationary pressures. Additionally, the NPL coverage increased to 80.0%, from 74.5% in Q3’2021 as a result of a 10.3% increase in general provisions, which outpaced the 2.0% growth in Gross non-performing loans. This points towards increased provisioning by the bank amidst the tough operating environment on the back of the elevated cost of living,

3. **Improved efficiency levels** – The Banks’s cost to income ratio without LLP improved, declining by 4.4% to 39.7%, from 44.1% in Q3’2021, an indication of improved efficiency, and,
4. **Improved Lending** – The Bank increased its lending in Q3’2022 with Loans and advances recording a 26.4% growth, highlighting the Bank’s aggressive lending despite the tough operating business environment.

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

I. Diversification - This is expected to reduce the bank’s reliance on interest income as well as increasing the bottom line. It 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 diversified in its digital offerings especially after the COVID-19 leading to 92.0% of all transactions happening outside. The uptake of “Timiza” which is a digital banking App, has also accelerated leading to higher Non-Interest Income. Notably, the Bank has continued to increase advancement of trade loans in corporate and business bank with trade loans contributing 14.9% of the total loan book in Q3’2022.

Valuation Summary

- We are of the view that ABSA Bank Kenya is an “***BUY***” with a target price of Kshs 16.9, representing an upside of 43.5%, from the current price of Kshs 11.8 as of 2nd December 2022, inclusive of a dividend yield of 8.5%,
- ABSA Bank Kenya is currently trading at a P/TBV of 1.0x and a P/E of 5.5x vs an industry average of 0.9x and 3.8x, respectively.