ABSA Bank Kenya Plc – H1'2023

29th August, 2023

Below is a summary of ABSA Bank Kenya Plc H1'2023 performance:

Balance Sheet Items	H1'2022	H1'2023	y/y change
Government Securities	120.8	116.0	(3.9%)
Net Loans and Advances	261.5	317.9	21.6%
Total Assets	**445.3**	**503.7**	**13.1%**
Customer Deposits	281.7	332.6	18.1%
Deposits per branch	3.4	3.9	16.7%
Total Liabilities	389.0	440.0	13.1%
Shareholders' Funds	**56.2**	**63.7**	**13.3%**

Balance Sheet Ratios	H1'2022	H1'2023	% y/y change
Loan to Deposit Ratio	92.9%	95.6%	2.7%
Govt Securities to Deposit ratio	42.9%	34.9%	(8.0%)
Return on average equity	21.4%	27.7%	6.3%
Return on average assets	2.7%	3.5%	0.7%

Income Statement	H1'2022	H1'2023	y/y change
Net Interest Income	14.4	19.2	33.2%
Net non-Interest Income	6.5	8.1	25.7%
Total Operating income	**20.9**	**27.4**	**30.9%**
Loan Loss provision	(3.0)	(5.2)	74.4%
Total Operating expenses	(11.8)	(15.3)	29.7%
Profit before tax	**9.1**	**12.1**	32.5%
Profit after tax	**6.3**	**8.3**	**32.0%**
Core EPS	**1.2**	**1.5**	**32.0%**

Income Statement Ratios	H1'2022	H1'2023	y/y change
Yield from interest-earning assets	9.7%	11.5%	1.8%
Cost of funding	2.7%	3.3%	0.6%
Net Interest Margin	7.6%	9.0%	1.4%
Net Interest Income as % of operating income	69.0%	70.3%	1.3%
Non-Funded Income as a % of operating income	31.0%	29.7%	(1.3%)
Cost to Income Ratio	56.4%	55.9%	(0.5%)
Cost to Income (Without LLPs)	42.3%	37.0%	(5.3%)

Capital Adequacy Ratios	H1'2022	H1'2023	% points change
Core Capital/Total Liabilities	18.1%	17.3%	(0.8%)
Minimum Statutory ratio	8.0%	8.0%	
Excess	**10.1%**	**9.3%**	**(0.8%)**
Core Capital/Total Risk Weighted Assets	14.0%	13.5%	(0.5%)
Minimum Statutory ratio	10.5%	10.5%	
Excess	**3.5%**	**3.0%**	**(0.5%)**
Total Capital/Total Risk Weighted Assets	16.4%	17.7%	1.3%
Minimum Statutory ratio	14.5%	14.5%	
Excess	**1.9%**	**3.2%**	**1.3%**
Liquidity Ratio	30.3%	28.7%	(1.6%)
Minimum Statutory ratio	20.0%	20.0%	
Excess	**10.3%**	**8.7%**	**(1.6%)**

Income Statement

- Core earnings per share increased by 32.0% to Kshs 1.5, from Kshs 1.2 in H1'2022, driven by the 30.9% growth in total operating income to Kshs 27.4 bn, from Kshs 20.9 bn in H1'2022, which outpaced the 29.7% growth in total operating expenses to kshs 15.3 bn, from Kshs 11.8 bn in H1'2022,
- The 30.9% growth in total operating income was mainly driven by a 33.2% growth in Net Interest Income to Kshs 19.2 bn, from Kshs 14.4 bn in H1'2022, coupled with a 25.7% growth in Non funded Income (NFI) to Kshs 8.1 bn, from Kshs 6.5 bn in H1'2022,
- Interest income grew by 36.9% to Kshs 25.2 bn from Kshs 18.4 bn in H1'2022, mainly driven by a 51.4% growth in interest income from loans and advances to Kshs 20.2 bn from Kshs 13.3 bn in H1'2022, coupled with a 3.6% increase in interest from government securities to kshs 4.7 bn, from kshs 4.6 bn in H1'2022. The Yield on Interest-Earning Assets (YIEA) increased by 1.9% points to 11.5% from 9.7% recorded in H1'2022, mainly attributable to the faster 35.1% growth in trailing interest income to kshs 47.7 bn, from kshs 35.3 bn in H1'2022 compared to a 13.0% increase in average interest earning assets to Kshs 412.9 bn, from Kshs 365.5 bn in H1'2022,
- Interest expenses rose by 50.3% to Kshs 6.0 bn, from Kshs 4.0 bn in H1'2022, driven by 40.9% increase in interest expense on customer deposits to Kshs 4.7 bn, from Kshs 3.3 bn in H1'2022, coupled with a 102.0% increase in interest expense from deposits and placements to Kshs 1.3 bn in H1'2023, from Kshs 0.6 bn recorded in H1'2022. Consequently, Cost of funds (COF) increased by 0.6% points to 3.3% from 2.7% recorded in H1'2022, owing to a faster 39.1% increase in Trailing interest expense to Kshs 10.5 bn, from Kshs 7.6 bn recorded in H1'2022, which outpaced the 13.9% increase in average interest bearing liabilities to Kshs 318.3 bn from Kshs 279.5 bn in H1'2022. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) increased by 1.4% points to 9.0% from 7.6% in H1'2022, attributable to a 34.0% increase in trailing net interest income to kshs 37.1 bn, from kshs 27.7 bn in H1'2022 which outpaced the 13.0% growth in average interest earning assets to Kshs 412.9 bn, from Kshs 365.5 bn recorded in H1'2022,
- Non-Funded Income (NFI) increased by 25.7% to Kshs 8.1 bn from Kshs 6.5 bn in H1'2022, mainly driven by a 27.6% increase in other fees and commissions to Kshs 3.0 bn from Kshs 2.3 bn in H1'2022, coupled by a 25.9% increase in the foreign exchange trading income to Kshs 3.8 bn from Kshs 3.0 bn in H1'2022, highlighting the bank's increased foreign exchange margins. The revenue mix shifted to 70:30 from 69:31 for the funded to Non-funded income owing to the 33.2% growth in Funded Income which outpaced the 25.7% growth in the Non Funded Income,
- Total operating expenses increased by 29.7% to Kshs 15.3 bn from Kshs 11.8 bn in H1'2022, driven by 74.4% increase in loan loss provisions to Kshs 5.2 bn from Kshs 3.0 bn recorded in H1'2022, coupled with a 16.5% increase in staff costs to Kshs 5.6 bn from Kshs 4.8 bn in H1'2022. The increase in provisioning is partly attributable to rising credit risk as a result deteriorioted economic environment as evidenced by the average Purchasing Managers Index (PMI) of 48.7 in H1'2023, down from an average of 49.3 in H1'2022,
- Cost to Income Ratio (CIR) decreased marginally to 55.9% from 56.4% in H1'2022, owing to the 30.9% increase in total operating income, which outpaced the 29.7% increase in total operating expense. Notably, CIR without LLP decreased by 5.2% points to 37.0% from 42.3% recorded in H1'2022, and,
- Profit before tax increased by 32.5% to Kshs 12.1 bn from Kshs 9.1 bn in H1'2022, with effective tax rate increasing to 31.2% in H1'2023 from 30.9% in H1'2022. Similarly, profit after tax increased by 32.0% to kshs 8.3 bn, from kshs 6.3 bn in H1'2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 13.1% to Kshs 503.7 bn, from Kshs 445.3 bn in H1'2022, driven by a 21.6% loan book expansion to Kshs 317.9 bn, from Kshs 261.5 bn in H1'2022. However, the expansion in total assets was weighed down by the 3.9% decline investment in government securities to Kshs 116.0 bn from Kshs 120.8 bn in H1'2022,

- Total liabilities rose by 13.1% to Kshs 440.0 bn from Kshs 389.0 bn in H1'2022, driven by the 18.1% growth in customer deposits to Kshs 332.6 bn, from Kshs 281.7 bn in H1'2022, coupled with a 67.9% increase in placements to 11.4 bn, from Kshs 6.8 bn recorded in H1'2022. With 85 branches countrywide compared to 83 branches in H1'2022, deposits per branch increased by 16.7% to Kshs 3.9 bn, from Kshs 3.4 bn in H1'2022,

- The faster 21.6% growth in net loans and advances as compared to the 18.1% growth in customer deposits led to an increase in the loan to deposits ratio to 95.6%, from 92.9% in H1'2022,
- The bank's Asset Quality deteriorated, with Gross NPL ratio increasing to 9.5% in H1'2023 from 7.1% in H1'2022, attributable to 62.6% increase in gross non-performing loans to Kshs 32.2 bn, from Kshs 19.8 bn in H1'2022, which outpaced the 22.8% increase in gross loans to Kshs 340.3 bn, from Kshs 277.1 bn recorded in H1'2022,
- General Provisions (LLP) increased by 34.8% to Kshs 17.7 bn in H1'2023 from Kshs 13.1 bn in H1'2022. The NPL coverage decreased to 69.4% in H1'2023, from 78.5% in H1'2022, attributable to 62.6% increase in gross non-performing loans to Kshs 32.2 bn, from Kshs 19.8 bn in H1'2022, which outpaced the 34.8% increase in general provisions to Kshs 17.7 bn from kshs 13.1 bn recorded in H1'2022.
- Shareholders' funds increased by 13.3% to Kshs 63.7 bn in H1'2023, from Kshs 56.2 bn in H1'2022, supported by a 16.6% increase in retained earnings to Kshs 62.9 bn, from Kshs 53.9 bn in H1'2022,
- ABSA Bank Kenya Plc remained capitalized with a core capital to risk-weighted assets ratio of 13.5%, 3.0% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 17.7% exceeding the statutory requirement of 14.5% by 3.2% points, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.5%, and a Return on Average Equity (ROaE) of 27.7%.

Key Take-Outs:

1. **Increased earnings -** Core earnings per share (EPS) increased by 32.0% to Kshs 1.5, from Kshs 1.2 in H1'2022, driven by the 30.9% growth in total operating income to Kshs 27.4 bn, from Kshs 20.9 bn in H1'2022, which outpaced the 29.7% growth in total operating expenses to kshs 15.3 bn, from kshs 11.8 bn in H1'2022,
2. **Increased Provisioning –** On the back of high credit risk occasioned by the deteriorated business environment, the bank increased its provisions holdings to cover for the anticipated losses in the future, with its provisions increasing by 34.8% to Kshs 17.7 bn from Kshs 13.1 bn recorded in H1'2022, and,
3. **Improved Lending –** The Group's loan book increased by 21.6% to kshs 317.9 bn, from kshs 7261.5 bn in H1'2022, which outpaced the 3.9% decline investment in government securities to Kshs 116.0 bn from Kshs 120.8 bn in H1'2022, highlighting the Group's strategy to increase lending while at the same time managing its non performing loan book,

Going forward, the factors that would drive the bank's growth would be:

- **Continued Mordernization of Financial Services** - The bank has continued to maximize on digital transformation and mordernization of its financial services. The bank continues to support SMEs through its Wezesha Biashara proposition, and has launched first-to-market digital solutions such as Mobi-Tap, which enables safe card-based mobile payments, and Absa Buy Now Pay Later proposition. The digital channel transactions has led to increase in NFI by 25.7% in H1'2023 to kshs 8.1 bn, from kshs 6.5 bn in H1'2022, mainly on the back of increased mobile and internet banking.

Valuation Summary

- We are of the view that ABSA Bank is a "buy" with a target price of Kshs 14.7 representing an upside of 41.4%, from the current price of Kshs 11.4, inclusive of a dividend yield of 11.9%.
- ABSA Bank is currently trading at a P/TBV of 0.9x and a P/E of 4.4x vs an industry average of 0.8x and 3.6x respectively.