

We maintain our **BUY** recommendation on Absa Kenya, with a target price of KES 12.73, representing an upside of 15.2% from the current market price of KES 11.05 as at 30/11/2021. The stock is currently trading at a trailing P/B of 1.1x and a forward P/B of 1/1x with dividend payment set to resume in FY2021.

Key Considerations

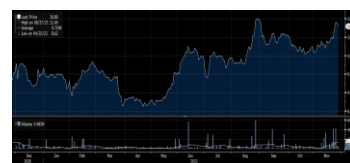
- Non-funded income growth:** Non-funded income has registered steady growth over the period. As the bank continues to focus on business diversification under the 5 year Growth, Transformation and Returns strategy, we expect this to support NFI growth further. We expect contribution to rise to 32.4% by FY2025.
- Lower Cost of Funds:** We expect the cost of funds to decline to 2.3% and remain flat thereafter as the bank continues to focus on cheaper deposits. We note that customer deposits have been on the rise, with the bank gaining market share in FY2019.
- Operational efficiency:** We expect the cost-to-income ratio (excluding provisions) to continue declining as the bank leverages on digitization and innovation. The C/I (excl provisions) has previously been improving on the back of staff reductions, property exits and an increase in non-bank transactions. We expect this to ease to 46.1% in FY2021.

Key data	
Target Price (KES)	12.73
Market price (KES)- 30/11/21	11.05
Upside	15.2%
No. of shares (mn)	5,432
Market Cap (KESmn)	59,475.3
Free float	30.4%
Dividend yield	0%

Major Shareholders	% of shares
Absa Group	68.50
Patel, Balooobhai	0.78
KCB Nominees	0.77
StanChart Nominees	0.70
Others	26.68

YTD Change	14.4%
Min 52 weeks KES	11.25
Max 52 weeks KES	8.62

Price performance



Key Metrics	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
EPS	1.28	1.37	1.44	1.74	1.97	2.37	2.71	2.71	2.71
DPS	1.00	1.10	1.10	-	1.10	1.20	1.20	1.20	1.20
BVPS	8.12	8.14	8.42	8.30	10.40	10.79	11.19	11.64	12.13
P/B	1.18	1.35	1.60	1.13	1.05	1.01	0.97	0.94	0.90
P/E	7.50	7.99	9.24	5.56	5.45	4.43	3.87	3.87	3.87
Div Yield	10.4%	10.0%	8.2%	-	10.1%	12.6%	12.56%	12.6%	12.6%
ROaE	16.0%	16.8%	17.5%	20.2%	22.5%	21.0%	19.8%	21.1%	22.5%
RoAa	2.6%	2.5%	2.3%	2.5%	2.6%	2.6%	2.5%	2.7%	2.8%
C/I Ratio (excl. provisions)	55.5%	54.2%	50.5%	46.6%	46.1%	44.9%	44.6%	43.5%	42.4%

3Q2021 FINANCIAL RESULTS

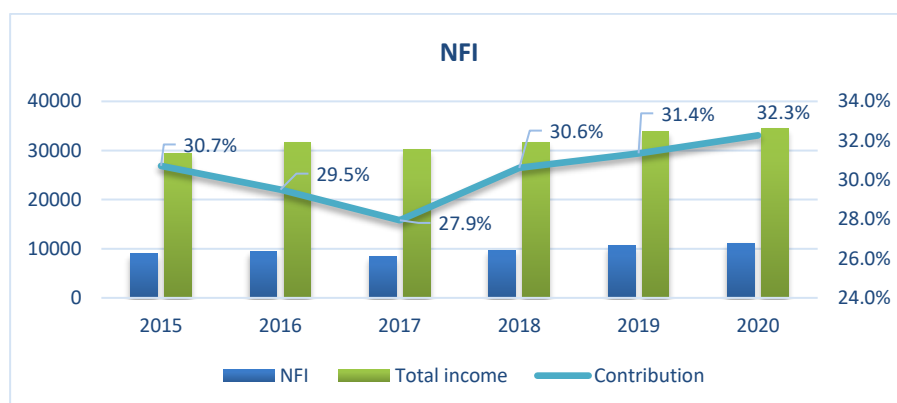
Absa Kenya's after tax profit for 3Q2021 surged by 328.3% y/y to KES 8.2 billion (3Q2020: KES 1.9 billion). The significant rise in profitability was primarily driven by lower loan loss provisions, higher net interest income and a decline in staff costs.

a) Net Interest Income up drives Operating Income

Net interest income grew by 8.6% y/y to KES 18.8 billion (3Q2020: KES 17.1 billion) supported by a 19.1% y/y decline in interest expenses to KES 4.9 billion. Income from loans and advances rose (+3.9% y/y to KES 17.0 billion) while income from government securities fell (-8.2% y/y to KES 6.1 billion). Loan and advances rose by 9.5% y/y to KES 229.1 billion. We expect net loans advanced to rise to KES 279.8 billion in FY2025 with a CAGR of 6.7%, higher than the historical 5 year CAGR of 6.4%. We expect net interest income to edge up to KES 30.5 billion by FY2025.

b) Growth in Non-Funded Income

Non-funded income edged up by 5.2% y/y to KES 8.7 billion (3Q2020: KES 8.3 billion). The increase was primarily buoyed by growth in income from fees and commissions on loans and advances (+37.8% y/y to KES 1.3 billion). Non-funded income contribution to operating income however decreased to 32.0% from 32.7% in 3Q2020 (Tier 1 banks contribution 35.0%) owing to the faster rise in net interest income (+8.6% y/y to KES 1.5 billion). We note that the bank's NFI has been steadily rising from 2017, contributing 32.3% to total income in FY2020. We are optimistic about the bank's business diversification (bancassurance, Timiza, asset management) to continue growing NFI under the Transformation arm of the 5 year strategy. We expect NFI to grow to KES 11.8 billion in FY2021 and to contribute 32.4% to total income by FY2025.



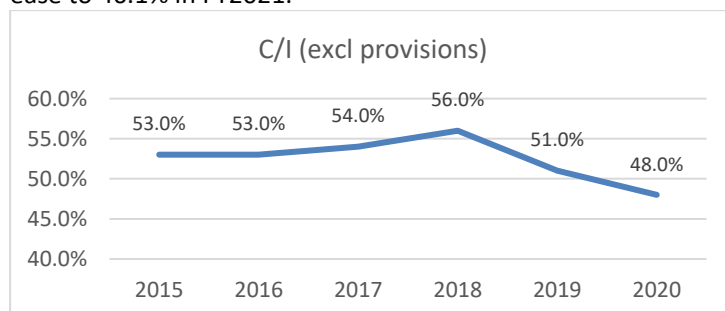
Source: Company Filings

c) Customer Deposits Growth

Customer deposits edged up by 9.0% y/y to KES 268.8 billion with cost of funds declining from 2.7% in FY2017 to 2.5% in FY2020. The bank gained deposit market share in FY2019 growing to 6.7% from a 5 year decline. The bank has been focused on cheaper deposits and managed to lower its cost of funds. We expect the cost of funds to ease further to 2.3% in FY2021 from 2.5% in FY2020.

d) Lower Operating Expenses

Operating expenses (excluding provisions) improved by 3.5% y/y to KES 12.0 billion driven by a decline in staff costs (-8.6% y/y). The cost-to-income ratio excluding provisions declined to 44.1% from 49.1% in 3Q2020. The trend in C/I is indicated below. We are optimistic in the continued improvement in operational efficiency. We expect the bank's focus on digitization to support efficiency and see the C/I ratio ease to 46.1% in FY2021.



Source: Company Filings

Separation costs:

No further costs were incurred by the bank in 3Q2021 (3Q2020: KES 1.9 billion) and this resulted in a 249.9% y/y

growth in profit after exceptional items. Going forward, no further separation costs are expected.

ABSA KENYA FINANCIALS

Income Statement (KES Mn)	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Interest income	27,171	29,061	31,024	31,440	33,746	34,656	35,343	37,168	39,342
Interest expense	(5,370)	(7,069)	(7,845)	(8,059)	(7,045)	(7,446)	(7,879)	(8,324)	(8,815)
Net Interest income	21,801	21,992	23,179	23,381	26,701	27,210	27,464	28,844	30,527
Net fee income	5,272	5,625	6,121	5,518	6,165	6,299	6,744	7,141	7,623
Forex income	3,215	4,045	4,179	5,129	5,551	5,877	6,227	6,588	6,987
Total non-funded income	8,457	9,702	10,589	10,700	11,769	12,229	13,025	13,782	14,662
Total operating income	30,258	31,694	33,768	34,081	38,470	39,439	40,489	42,626	45,189
Credit impairment losses	(3,115)	(3,871)	(4,201)	(8,585)	(5,418)	(5,906)	(6,455)	(6,137)	(6,551)
Staff costs	(10,255)	(9,921)	(10,679)	(11,312)	(9,963)	(9,673)	(9,778)	(9,885)	(9,992)
Total operating expenses	(16,782)	(17,177)	(18,815)	(19,849)	(17,725)	(17,720)	(18,038)	(18,551)	(19,154)
Profit before tax	10,361	10,250	12,281	5,647	15,327	15,813	15,996	17,938	19,485
Income tax expense	(3,435)	(3,230)	(3,296)	(1,484)	(4,854)	(5,008)	(5,066)	(5,681)	(6,171)
Profit for the Year	6,926	7,416	7,456	4,163	10,473	10,805	10,930	12,257	13,314

Balance Sheet (KES Mn)	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Assets									
Loans and advances	168,397	177,354	194,895	208,855	226,361	231,307	247,644	262,199	279,897
Investment Securities	58,476	63,230	79,221	89,682	91,995	101,748	104,764	108,292	112,099
Property and equipment	1,159	878	618	414	439	458	473	484	492
Total Assets	271,572	325,313	374,904	379,441	406,353	426,575	448,231	470,696	495,493
Liabilities									
Customer deposits	185,977	207,408	237,739	253,630	270,572	288,647	308,130	328,159	350,310
Other liabilities	9,150	10,313	14,380	15,819	15,819	15,819	15,819	15,819	15,819
Total Liabilities	227,474	281,107	329,715	332,936	349,878	367,953	387,436	407,465	429,616
Shareholders Equity	44,098	44,206	45,189	46,505	56,475	58,622	60,795	63,231	65,878
Total Equity and Liabilities	271,572	325,313	374,904	379,441	406,353	426,575	448,231	470,696	495,493

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Ratio Analysis									
Growth y/y %	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Assets	4.6%	19.8%	15.2%	1.2%	7.1%	5.0%	5.1%	5.0%	5.3%
Net Loans	(0.1%)	5.3%	9.9%	7.2%	8.4%	2.2%	7.1%	5.9%	6.7%
Deposits	4.4%	11.5%	14.6%	6.7%	6.7%	6.7%	6.7%	6.5%	6.7%
Non funded income	(0.1%)	14.7%	9.1%	1.0%	10.0%	3.9%	6.5%	5.8%	6.4%
Operating Expenses	(0.7%)	2.4%	9.5%	5.5%	-10.7%	-0.0%	1.8%	2.8%	3.2%
Net Profit	(6.4%)	7.1%	0.5%	(44.2%)	151.6%	3.2%	1.2%	12.1%	8.6%
Margins									
Yield on interest earning assets	11.9%	11.9%	11.4%	10.6%	10.7%	10.4%	10.1%	10.1%	10.1%
Cost of funds	2.7%	3.1%	2.9%	2.5%	2.3%	2.3%	2.3%	2.3%	2.3%
Net Interest Margin (NIMs)	9.6%	9.0%	8.5%	7.9%	8.4%	8.1%	7.8%	7.8%	7.8%
Balance Sheet									
Gross Loans/Deposits	94.56%	90.44%	90.50%	90.60%	89.00%	85.25%	85.50%	85.00%	85.00%
Net Loans/Deposits	90.55%	85.51%	81.98%	82.35%	83.66%	80.14%	80.37%	79.90%	79.90%
Loans/Assets	62.0%	54.5%	52.0%	55.0%	55.7%	54.2%	55.2%	55.7%	56.5%
Investment Securities/Deposits	31.44%	30.49%	27.00%	24.00%	34.00%	35.25%	34.00%	33.00%	32.00%
P&L									
Interest income/operating income	72.1%	69.4%	68.6%	68.6%	69.4%	69.0%	67.8%	67.7%	67.6%
Non interest income/operating income	27.9%	30.6%	31.4%	31.4%	30.6%	31.0%	32.2%	32.3%	32.4%
Staff costs/operating expenses	-61.1%	-57.8%	-65.5%	-68.4%	56.2%	54.6%	54.2%	53.3%	52.2%
C/I ratio (provisions excluded)	55.5%	54.2%	50.5%	46.6%	46.1%	44.9%	44.6%	43.5%	42.4%
Asset Quality									
NPLs/Gross Loans	4.2%	5.5%	5.2%	7.1%	6.8%	6.7%	6.2%	5.9%	5.5%

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Glossary of Terms

Net Interest Margin (NIM) - Net interest margin is a measure of the difference between interest paid and interest received, adjusted for the total amount of interest-generating assets held by the bank. It is calculated as: $\text{Net Interest Income} / \text{Average Interest Earning Assets}$

Basis points (bps) – one hundredth of a percentage i.e. 1.0%=100bps or 1bps=0.01%

Target price – Analyst estimate of the fair value or intrinsic value of the company

Cost of Funds-This is the effective average interest rate paid on interest earning liabilities. It is calculated as $\text{Total Interest Expense} / \text{Average Interest Earning Liabilities}$

Loan Yield- This is the effective average interest rate received on average loans and advances. It is calculated as $\text{Interest on Loans and Advances} / \text{Average Loans and Advances}$

Cost of Risk – This ratio measures the amount of risk involved in lending. It is calculated as: $\text{Net Impairment Provisions} / \text{Average Gross Loans in the period}$

Non-performing loans-These are loans that have been classified as impaired. The CBK classifies loans into five categories i.e. Normal, Watch, Substandard, Doubtful and Loss depending on performance of the loan. The last three i.e. sub-standard, doubtful and loss are referred to as non-performing loans. Under IFRS, these classified as stage 3 loans.

Non-performing loans (NPL) Ratio - This is the proportion of NPLs in the loan book. It is calculated as $\text{Gross NPLs} / \text{Gross Loans}$

Non-funded/Non-Interest Income– This represents the income that is not classified as interest income.

Non-Funded/Non-Interest Income Ratio. This represents the proportion of total operating income that is not classified as interest income. It is calculated as $\text{Non-Interest Income} / \text{Total Operating Income}$

Composite market share (Market share Index) - This is a weighted composite index comprising of assets, deposits, capital size, number of deposit and loan accounts. The composite market share is used by CBK to classify banks into three groups:

- Tier 1(Large Size Bank); Composite market share of 5.0% and above
- Tier 2(Medium Size Bank); Composite market share of between 1.0% and 5.0%
- Tier 3(Small size Bank); Composite market share of less than 1.0%

Recommendation

BUY – Minimal risks to catalysts

SELL- Risks outweigh the catalysts

NEUTRAL – This is where the positives and negatives in a company almost balance out. You can accumulate for the long term.



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