

Harness the Hike

How Egypt banks can make the best of a hawkish CBE

Banks are heavily regulated by nature, and the implications of these regulations on their value cannot be overlooked. A change in one factor can have a domino effect on the entire banking sector, as we have seen in Egypt after several consecutive regulatory changes. The abrupt challenges brought about by the pandemic in 2020 were definitely revealing as they helped highlight points of strengths and weaknesses in Egypt banks. The sector in aggregate managed to navigate through those implications; some banks even have remarkably turned the situation into an advantage.

In this note, we discuss our main findings, not only taking a deeper look in the rear view mirror but also, forecasting this year which is seemingly just as volatile as last year. Ten EGX-listed banks are covered in this thematic note (please see Figure 1).

Figure 1: Primary KPIs (Impact based on 2021 financials)

Ticker	Market Cap (EGPmn)	P/E	P/B	12M PT*	Upside	DY	Impact of EGP depreciation	Impact of Interest rate hike
ADIB	5,120	3.4x	0.8x	21.7	70%	N/A	Neutral	Positive
CANA	2,382	3.9x	0.5x	N/A	N/A	N/A	Neutral	Neutral
CIEB	7,800	4.6x	1.0x	9.2	47%	12%	Positive	Positive
COMI	92,227	6.2x	1.4x	70.7	52%	3%	Positive	Neutral
EGBE	2,986	4.3x	0.5x	N/A	N/A	N/A	Neutral	Neutral
EXPA	2,622	4.3x	0.4x	11.1	39%	N/A	Negative	Negative
FAIT	8,371	2.5x	0.5x	19.7	43%	9%	Positive	Neutral
HDBK	5,711	3.1x	0.6x	46.5	24%	7%	Neutral	Positive
QNBA	37,666	4.9x	0.8x	18.8	7%	4%	Positive	Positive
SAUD	3,415	3.0x	0.6x	25.6	66%	N/A	Positive	Negative

* Net of DPS distribution; prices as of 12 May 2022.
Source: Banks' financials, Prime Research.

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STOCKS COVERED IN THIS NOTE

- | | |
|----------|-----------|
| 1. ADIB* | 6. EXPA* |
| 2. CANA | 7. FAIT* |
| 3. CIEB* | 8. HDBK* |
| 4. COMI* | 9. SAUD* |
| 5. EGBE | 10. QNBA* |

* Stocks within our Core Coverage universe.



NIM Analysis: The Comeback

Almost all banks saw NIMs slip in 2021: NIMs across the 10 banks slipped in 2021 to an average of 5.00% vs. 5.36% in 2020. CANA came in last with the lowest NIM of 3.46%, while CIEB boasted the highest NIM of 6.61%. **Banks that originally had the highest NIMs suffered the most in 2021.** COMI’s NIM dropped 84bps y/y to 5.95%, QNBA’s declined 81bps y/y to 5.86%, and CIEB’s declined 72bps y/y to 6.61%. **Banks’ yields were lower in 2021**, averaging 10.42%, down from 11.64% a year before. This pushed them to increase the volume of their interest-earning assets (IEA) to balance out the effect of the yield decline in order to grow their net interest income (NII). For instance, SAUD increased its IEA by 33% y/y, HDBK by 29% y/y, QNBA by 28% y/y, and ADIB by 20% y/y. **The only two banks that have been able to grow their NIMs despite the low yields were FAIT and EGBE.** FAIT successfully exploited its low interest costs and managed to increase its NII by 19% y/y, distinguishing its NIM by a 19bps y/y increase to 5.19%. Similarly, EGBE’s NIM widened by 12bps y/y to 4.34%. We note that the **banks’ cost of funds was also down in 2021**, averaging 5.54%, down from 6.10% in 2020.

What caused the change in NIM? Granted, the change in NIM—whether a decrease or an increase—is driven by either the yield on IEA or the cost of interest-bearing liabilities (IBL), depending on each bank’s asset-liability management (ALM). For example, although **both FAIT and EGBE increased their NIMs**, each had a different driver behind the change. **EGBE’s NIM was yield driven**, while **FAIT stood out as the only cost-driven bank** with one of the cheapest pool of deposits in the market. Meanwhile, **the remaining banks, which saw their NIMs decline**, were **yield driven** although the intensity of the change varies (please see Figure 5).

What to expect? We expect yields to improve gradually, especially after the latest interest rate hike. The interest rate cuts in 2020 took time to filter through banks’ income statements, impacting each bank differently depending on its assets/liability structure. Similarly, we expect improving yields to impact banks’ profitability margins gradually in 2022, causing NIMs to stabilize, rather than expand, at pre-pandemic levels.

Figure 2: Net Interest Margin

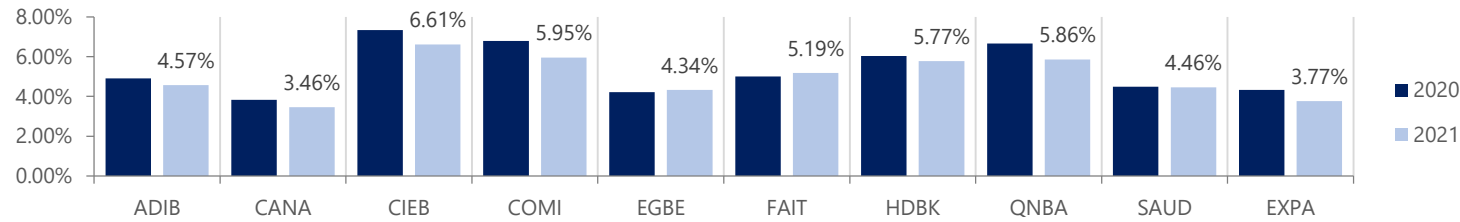


Figure 3: Spread

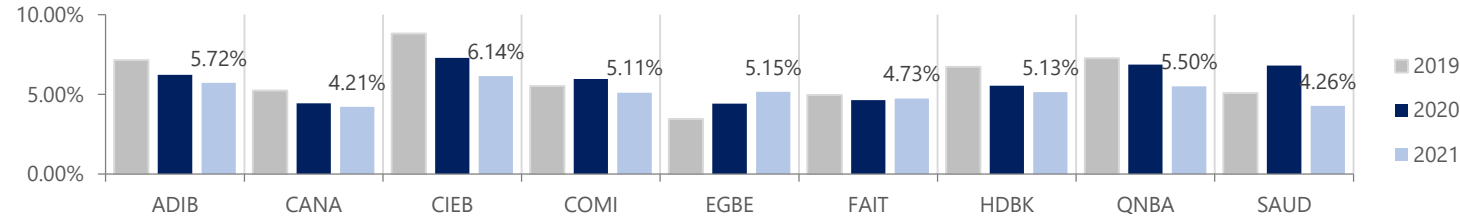


Figure 4: Cost of funds

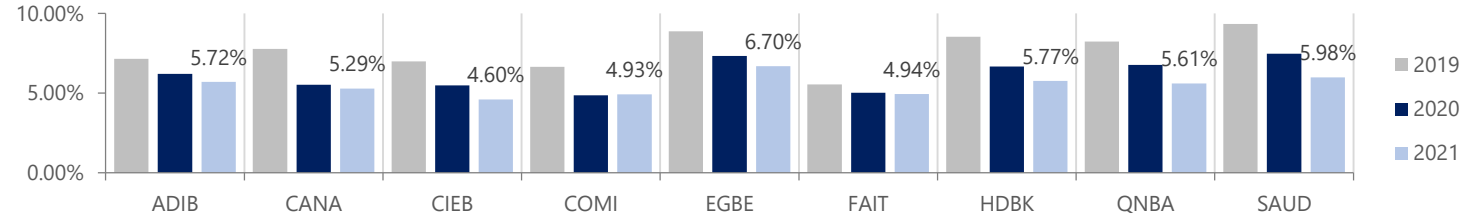
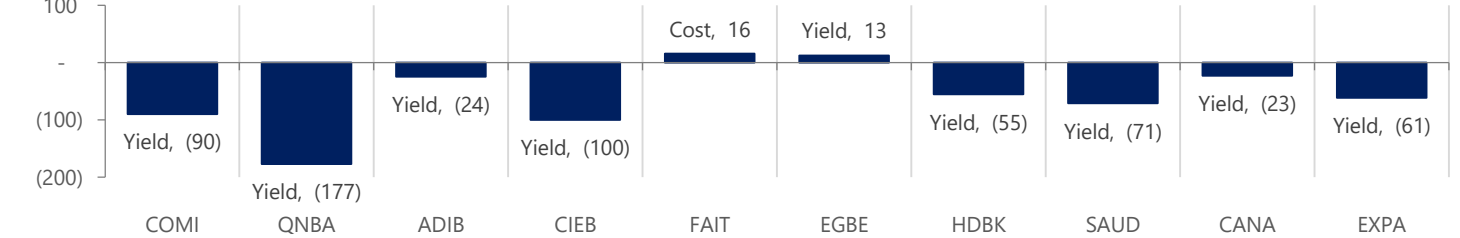


Figure 5: NIM change drivers in 2021 and change in bps y/y



Source: Banks’ financials, Prime Research.

Repricing Gap: A Meaningful Space

In the aftermath of COVID-19, inflation rates have been rising globally. With recent geopolitical events adding fuel to the fire, central banks all over the world were inclined to raise interest rates, and Egypt was no exception. As the tighter monetary policy already started with a 100bps hike, the Egyptian banking sector in general should stand to benefit the most. However, the extent to which each bank would be able to capitalize on the opportunity hinges upon its own maturity mix.

Who should benefit the most? The answer to this question lies in the “repricing gap”, which directly indicates whether a bank’s short-term assets could cover its short-term liabilities. This reflects how much of a bank’s short-term use of funds could be repriced to higher rates. **For a bank to benefit off this expected interest rate hike, its repricing gap must be positive (i.e. ST assets > ST liabilities).** Also, the wider the gap (as a percentage of total assets), the greater the potential benefit.

Most have it positive: We can see that most EGX-listed banks have a positive repricing gap, given that short-term working capital loans still dominate their lending. However, **this is not the case for SAUD and EXPA** which had negative repricing gaps of 18.5% and 27% of total assets, respectively. Rendering interest rate hikes potentially harmful.

Announcing the nominees: HDBK tops the list of beneficiaries with a positive repricing gap that represents 52% of assets, followed by ADIB (27%), CIEB (12.9%), QNBA (8%), and FAIT (6%). We note that **COMI managed to turn its short-term repricing gap to positive by end of 2021**, settling at 2% of assets, i.e. a would-be beneficiary in this vein, but not that much.

What to expect? Capex lending revival has been postponed for several rounds due to unfavorable economic conditions. We had initially expected the recovery of the economy to be tempting enough for capex lending appetite to be revived, which would in turn push more bank assets to be long term in nature. However, **with higher interest rates and with the ongoing turmoil resulting from the Russia-Ukraine war, working capital lending will continue to take the front seat.** Going forward, post 2022, with more stable conditions, we expect the assets ST repricing gap to contract and to even turn negative (i.e. ST liabilities repricing gap) for banks with more lending tendency and bigger asset size, such as **COMI** and **QNBA**.

Figure 6: Repricing gap

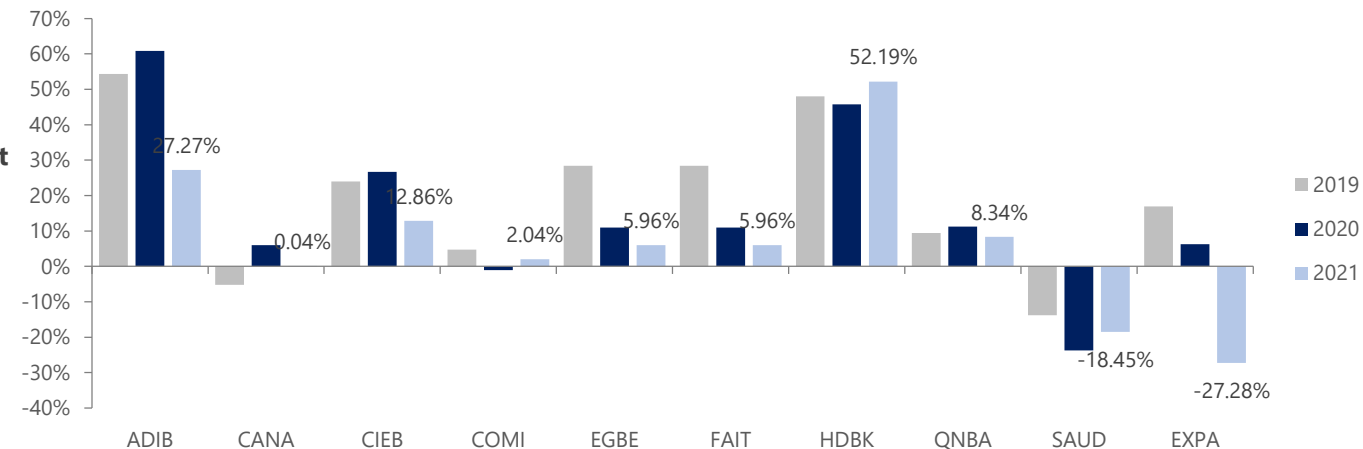
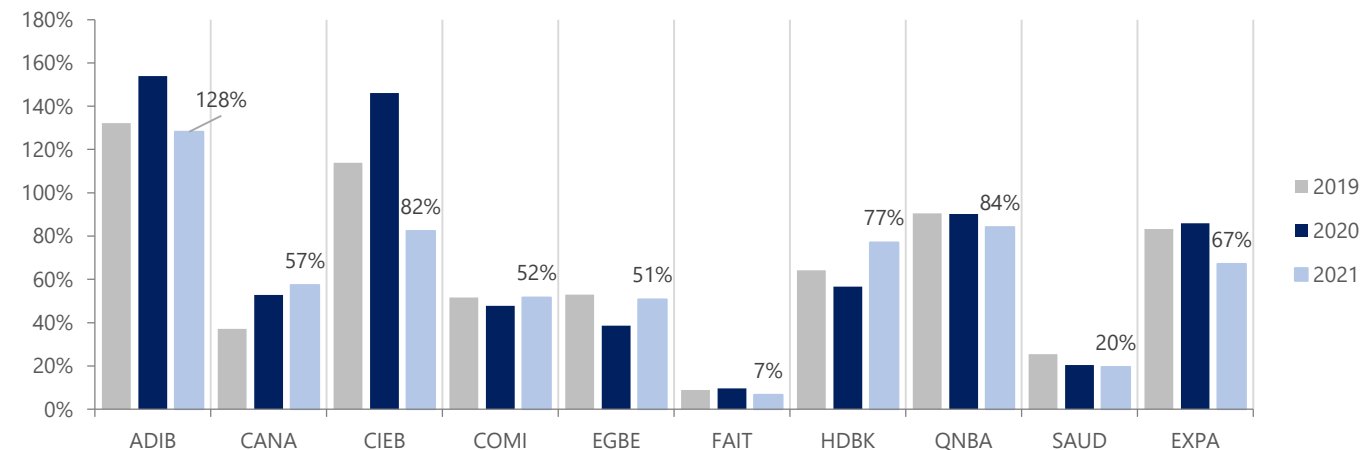


Figure 7: GLDR up to 1 year



Source: Banks' financials, Prime Research.

Asset Quality: A Bumpy Road

A very high base year: 2020 saw the booking of enormous amounts of credit provisions, as banks had to take precautionary measures to face uncertainty induced by the pandemic. These measures have affected bank's bottom lines throughout the past couple of years. However, **by end of 2021, we have seen most banks substantially decrease their credit provisions after an incredibly high base year.**

Cost of risk decreased: COMI and ADIB reduced their provisions by 66% y/y and 62% y/y, respectively, which boosted their net earnings strongly. For COMI in particular, it more than offset its tepid net interest income growth, leading to higher net income growth in 2021. Meanwhile, only two banks, namely SAUD and QNBA, adopted a different approach by bulking up their provisions; the former's increased 49% y/y, while the latter's increased by 5%. **Accordingly, all banks saw their cost of risk (CoR) fall, except for SAUD (+60bps y/y to 236bps) and EXPA (+68bps to 73bps), both coming way above the sector average of 104bps.**

Higher NPL accompany high loan growth: Despite an overall declining provisions trend, **NPLs increased at big-sized banks with the widest market exposure.** On the other hand, only three banks with small-sized loan books saw their NPL ratios decrease. FAIT's NPL ratio decreased by 289bps to 1.52%, followed by CANA (-284bps to 8.17%) and SAUD (-177bps to 3.29%).

What to expect? We had initially expected banks to let their guards down even further, leading the pattern of declining provisions to prevail longer. We had also expected to see provisions reversals in the P&Ls of most stable banks. However, **with the current global disruptions persisting going forward, accompanied with now higher interest rates and the recent EGP depreciation, the banking sector might sustain its CoR levels between 60-120bps in 2022 for prudence.**

Figure 8: Cost of risk

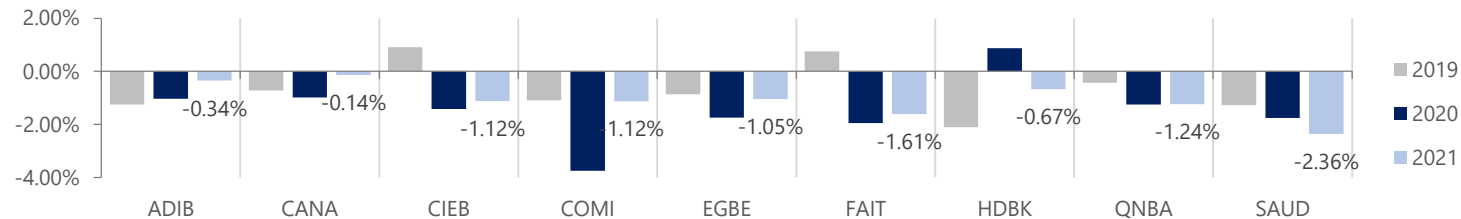


Figure 9: Non-performing loans (NPL) ratio

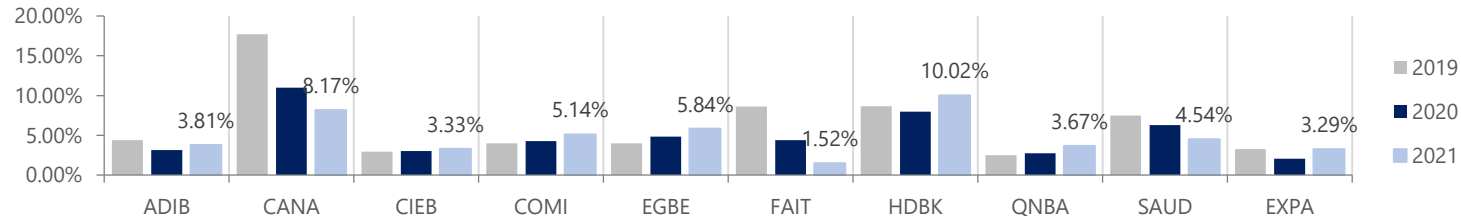


Figure 10: NPL coverage ratio

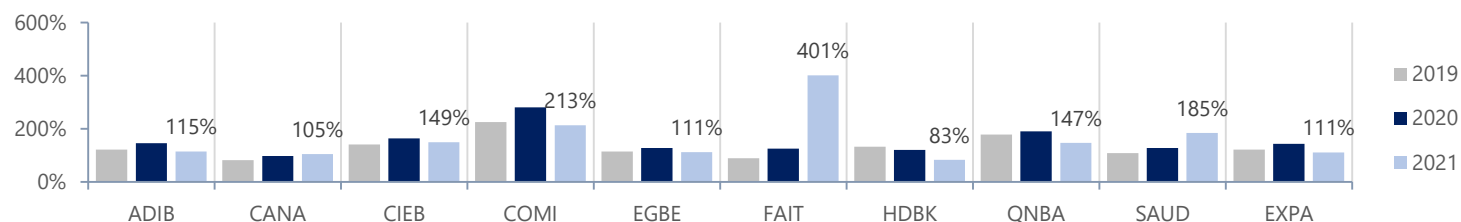
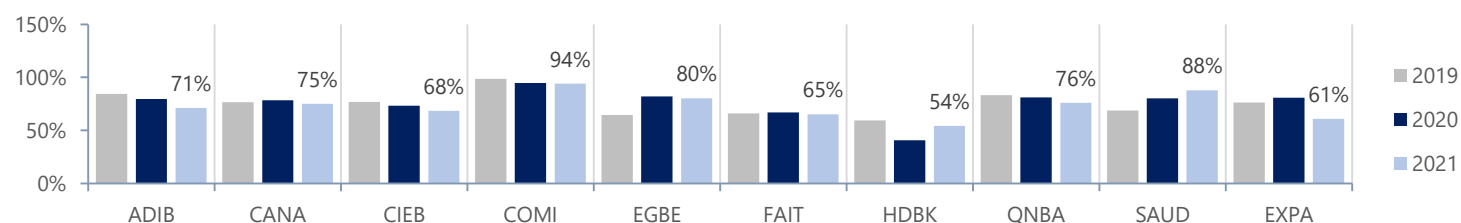


Figure 11: Stage III coverage ratio



Source: Banks' financials, Prime Research.

Credit Growth: Comes in All Sizes

Better-than-expected growth in the loan market: In 2020, total market lending jumped 32% y/y to EGP2.493tn. This was followed by a still-satisfying, yet slower, growth of 24% y/y to EGP3.0tn in 2021, while deposits grew c.24% to EGP6.4tn, leaving the market's average gross loans-to-deposits ratio (GLDR) at 48%. **The CBE's financing initiatives launched in the past couple of years helped boost loans and deposits.** Among big-sized banks, COMI managed to grow its loan book in 2021 by 20% (the highest among its peers), followed by CIEB (+14% YoY). Meanwhile, small-sized banks such as EXPA, CANA, and HDBK, grew their loan books by 28%, 26%, and 24%, respectively. We note that QNBA, the largest private-sector bank in terms of loan book, nudged it up by only 6%, reducing its loan allocation relative to total assets from 58% in 2020 to 49% in 2021.

Loan growth dissected: The increase in loans in 2021 was driven by corporate lending as business sentiment improved. In terms of currency, EGP-denominated loans led the growth of total market lending, contributing 99% and 86% of the change in total market lending in 2020 and 2021, respectively. Local currency loans also represents 80% of total market lending by end of 2021. In terms of maturity, **short-term lending still dominated banks' lending**, as capex lending needs a steadier atmosphere in order to return to pre-pandemic levels.

What to expect? Given the higher interest rates and an increasingly inflationary environment, **we see both credit and deposit growth moderating in 2022 at 14-16% y/y.**

Figure 12: Total loan market as a percentage of GDP

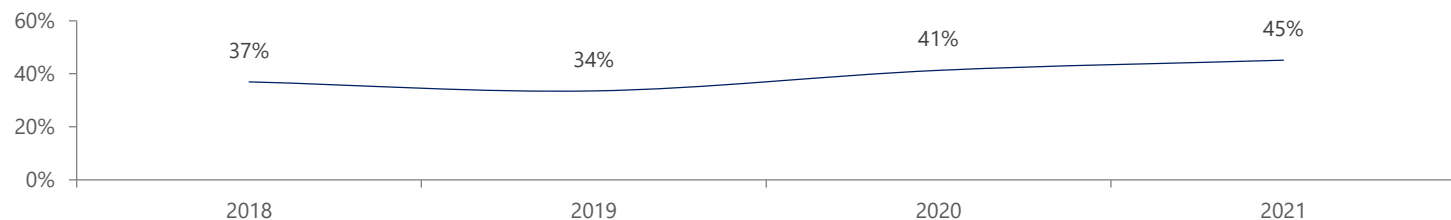


Figure 13: Local currency vs. Foreign currency as a percentage of total lending

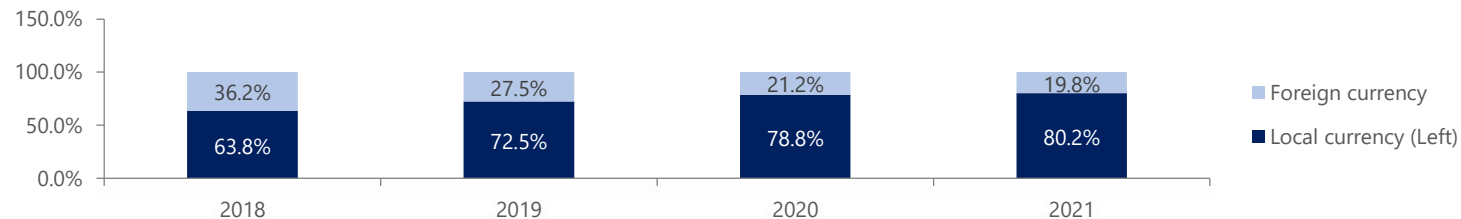


Figure 14: Total market assets to GDP

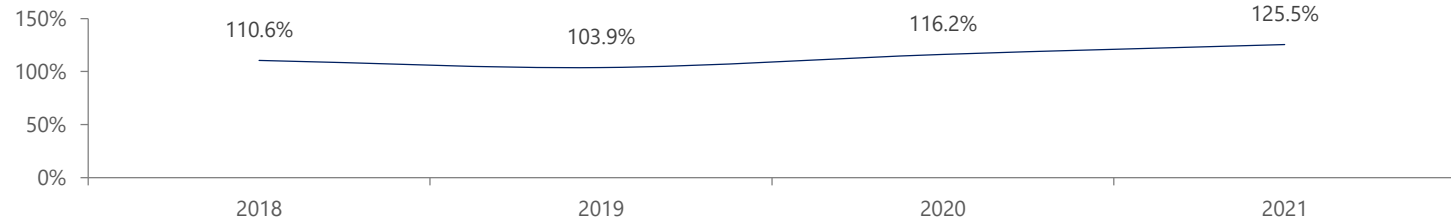
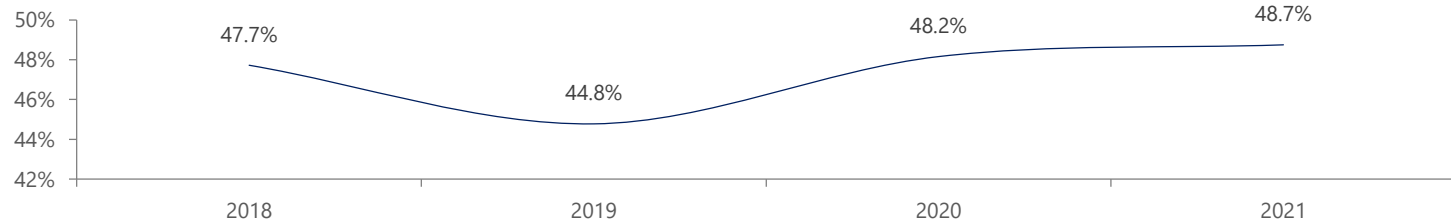


Figure 15: Total market gross loans to total market deposits



Source: Banks' financials, Prime Research.



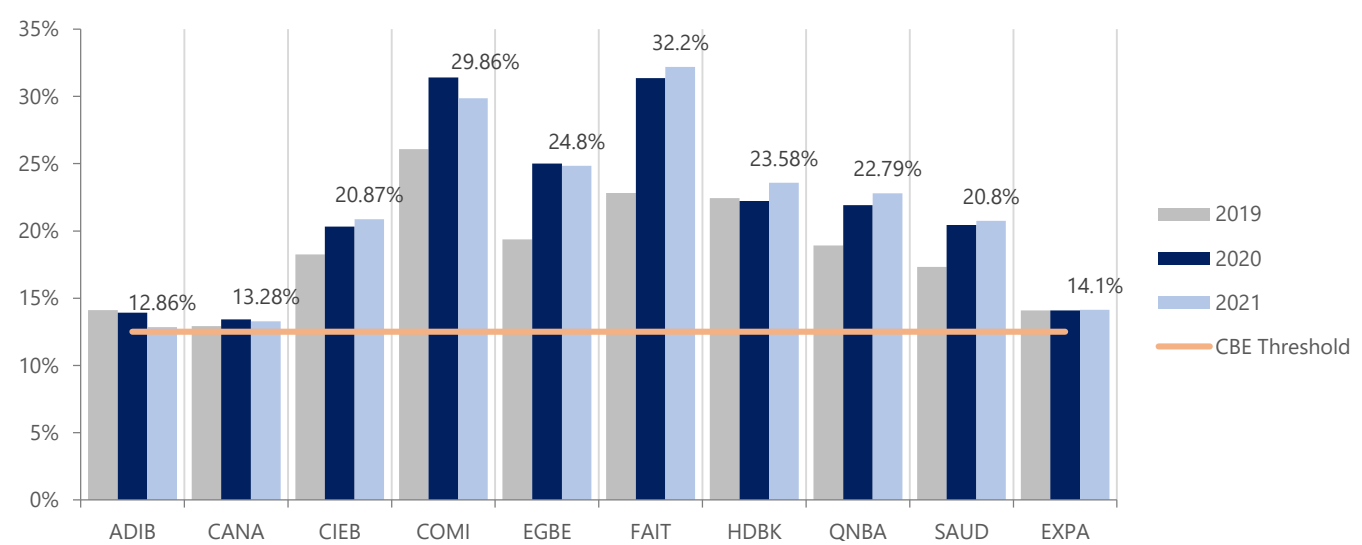
Soundness Indicators: Collateral Beauty

Robust capital adequacy: One of the most important measures the CBE took to control the impact of the pandemic was **having restricted banks from distributing cash dividends. This helped banks maintain high capital adequacy ratios (CARs) in 2021.** The only exception was ADIB which saw its CAR decline to 12.9%, coming slightly above the 12.5% threshold set by the CBE. On the flipside, FAIT achieved a CAR of 32.2%, the highest amongst its peers, drawing on its heavy Treasury allocation and small-sized loan book. Known for its cautious management, COMI came in second behind FAIT with a CAR of 29.9%.

Weaker ROAE despite earnings growth: Net income growth in 2021 was weakened by high provisions and/or lower NII. This translated into **weaker ROAE for EGX-listed banks in 2021**, averaging 18.4%, down from 20% in 2020. Still, CIEB, COMI, and FAIT managed to increase their ROAEs absent any pressure from low capital adequacy levels, unlike some of their peers. Meanwhile, **two banks, namely ADIB and EXPA, took meaningful steps to implement right issues to comply with the CBE’s minimum capital requirements.**

What to expect? We expect **banks’ CARs to remain strong through 2022**, even if the CBE approved all proposed cash dividends for 2021. Also, we believe banks’ ROAEs will improve in 2022 in view of the recent interest rate hike.

Figure 16: CAR



Source: Banks’ financials, Prime Research.

Figure 17: Banks’ DuPont analysis

	ADIB			CANA			CIEB			COMI			EGBE			FAIT			HDBK			QNBA			SAUD		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
ROA	1.8%	1.6%	1.5%	1.0%	1.1%	1.1%	4.7%	2.6%	2.6%	3.1%	2.4%	2.7%	1.0%	0.9%	0.9%	2.6%	1.8%	2.0%	3.8%	3.1%	2.4%	3.1%	2.6%	2.1%	1.4%	1.7%	1.4%
ATO	0.06x	0.05x	0.05x	0.03x	0.04x	0.04x	0.08x	0.07x	0.06x	0.06x	0.07x	0.06x	0.03x	0.04x	0.04x	0.04x	0.04x	0.04x	0.09x	0.06x	0.06x	0.06x	0.06x	0.05x	0.03x	0.04x	0.04x
Tax Burden	0.70x	0.68x	0.63x	0.57x	0.58x	0.58x	0.78x	0.70x	0.72x	0.71x	0.67x	0.71x	0.66x	0.61x	0.45x	0.77x	0.61x	0.62x	0.77x	0.72x	0.70x	0.74x	0.71x	0.69x	0.70x	0.62x	0.65x
CoR	77%	80%	93%	88%	84%	97%	108%	84%	87%	92%	75%	92%	83%	71%	87%	103%	94%	95%	86%	108%	94%	94%	83%	83%	86%	84%	76%
C/I	54%	56%	56%	60%	58%	52%	69%	63%	66%	72%	71%	72%	53%	48%	58%	75%	76%	81%	66%	63%	64%	75%	77%	75%	78%	87%	74%
FLM	15.0x	14.1x	13.8x	15.7x	14.1x	13.1x	7.0x	7.1x	6.9x	7.5x	7.2x	7.2x	14.4x	13.2x	14.0x	7.7x	8.0x	7.7x	8.5x	7.9x	8.3x	7.9x	7.4x	7.9x	17.9x	15.0x	13.7x
ROE	27.6%	22.3%	21.3%	16.4%	15.6%	13.7%	32.7%	18.8%	18.4%	22.8%	17.3%	19.5%	14.3%	11.4%	12.2%	20.3%	14.3%	15.7%	32.2%	24.4%	19.8%	24.3%	19.2%	16.5%	25.9%	24.8%	18.9%

Source: Banks’ financials, Prime Research.

Allocation: Save the Status Quo

Higher Treasury allocation: By the end of 2021, 36% of total banks' assets in the market were invested in Treasuries. The tendency of banks to seek relatively easy/high yield through government securities rather than extending credit to the private sector was evident in banks' 2021 financials. **Although most banks increased their investment in Treasuries y/y, some were more intensely focused on government debt than others.** FAIT allocated 62% of its total assets to Treasuries, increasing their investments by more than 200% in less than two years. Meanwhile, CIEB invested the least in government debt, allocating only 13% of its total assets.

The price of the safer option: The abovementioned tendency has put banks on the horns of a dilemma, given the high effective tax rate (ETR) they would have to pay according to the amended tax law that became effective in 2019. In 2021, CIEB's ETR of 28% was the lowest among other EGX-listed banks, while EGBE posted a record-high ETR of 55%. **The banks' weighted average ETR stood at 32.4% in both 2020 and 2021, up from 27% in 2019, given intensified investment in Treasuries.**

What to expect? Taking into consideration global inflation and interest rate hikes, we expect **banks to maintain their allocation to Treasuries in 2022.**

Figure 18: Treasury income as a percentage of interest income

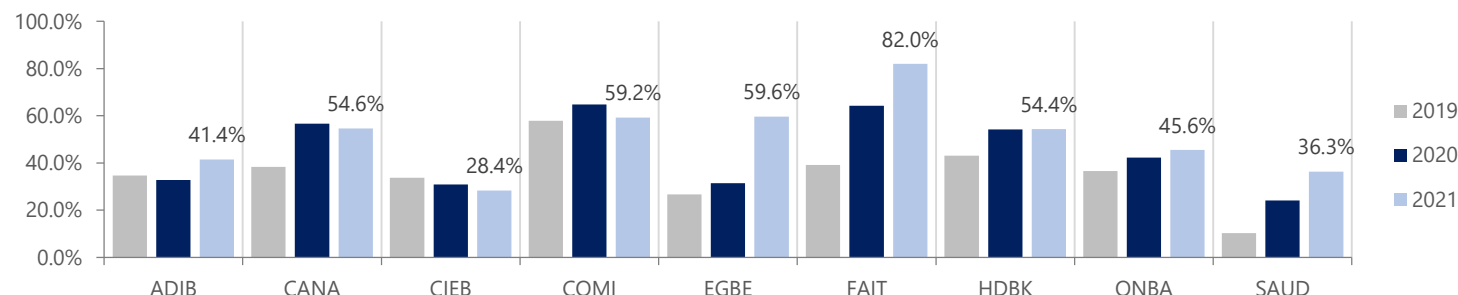


Figure 19: Effective tax rate

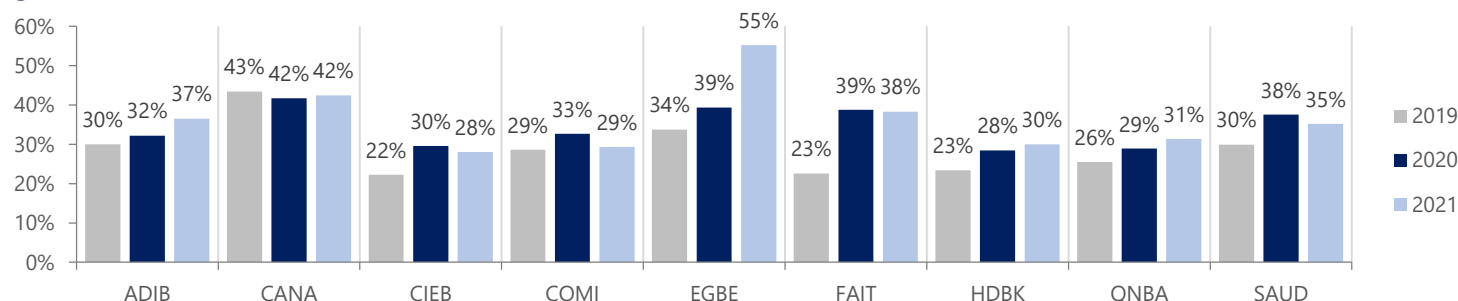
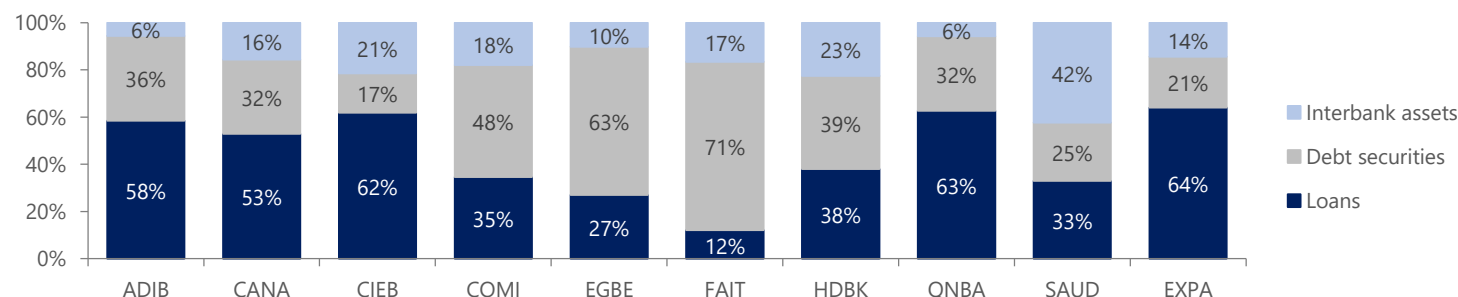


Figure 20: IEA mix 2021



Source: Banks' financials, Prime Research.

Weaker EGP: Riding the Wave

On 21 March 2022, the EGP depreciated by 14% against USD, which is positive for banks that are distinguished by the following characteristics related to foreign currency (FCY):

- **High percentage of FCY loan book:** A bank that has a notably high percentage of its loan book in FCY should benefit the most from a higher FX rate, which will reflect into higher loan book growth. COMI takes the lead with 30% of its loan book denominated in FCY, followed by CANA (27%), EXPA (16.9%), and QNBA (16%).
- **High percentage of FCY deposits:** The banks that have the highest percentage of FCY deposits would see their pool of funds expand, by virtue of EGP depreciation. FAIT and CANA both have a high percentage of FCY deposits, mounting to 26%, followed by COMI and CIEB with 23%. A high portion of FCY deposits usually implies lower average funding costs.
- **Net long FCY position:** Banks that own enough FCY assets to cover their FCY liabilities (i.e. those boasting a net FCY long position) will make the best use of the EGP depreciation. Thus, we would prefer banks that have the biggest net FCY position relative to their equity. FAIT, COMI, and QNBA stand on solid grounds with a net FCY position of 35.0%, 18.3%, and 12.4% respectively, making them the top beneficiaries. Meanwhile, EXPA is the only EGX-listed bank that has a net short FCY position of 2%, hindering the bank from taking advantage of a weaker EGP.
- **High FCY GLDR:** Even more important than having a high percentage of FCY deposits is to have a high utilization rate of these FCY deposits. In this vein, QNBA employs 74%, followed by COMI (52%) and CANA (49%), making the maximum use of funds under disposal.

What to expect? We note that investors should look out for banks that are traded in USD while their financials are reported in EGP, such as EGBE. This will cause the bank's P/E ratio to increase. Thus, **the more the EGP depreciates, the more expensive the bank's stock will be.** We also note that **only one name (COMI) ticks all the right boxes when it comes to the EGP depreciation.** COMI has (1) high FCY loan book exposure, (2) relatively high FCY deposits of total deposits, (3) a net long FCY position, and (4) a high FCY GLDR.

Figure 21: FCY GLDR 2021

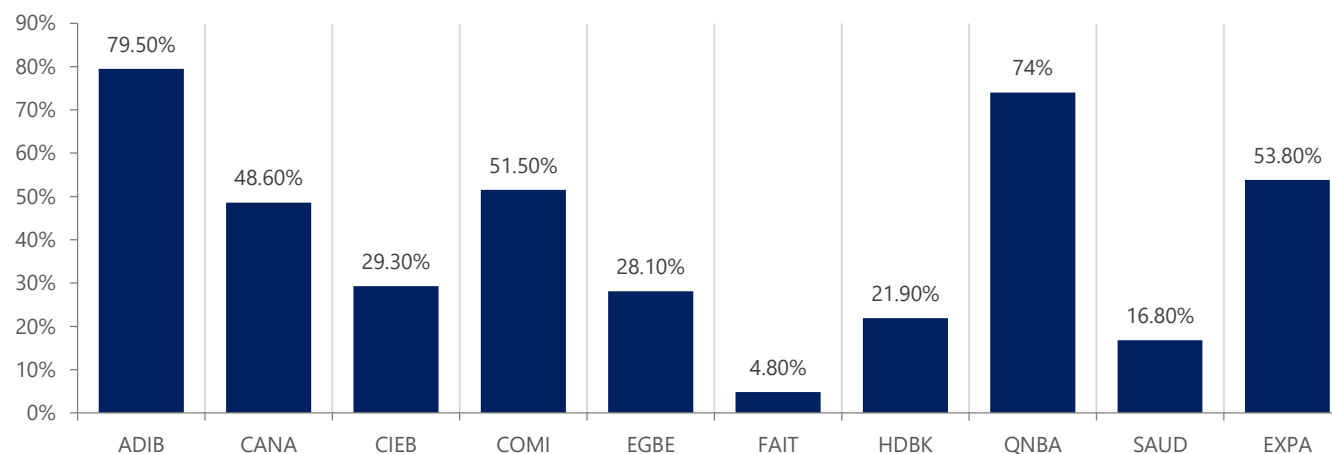
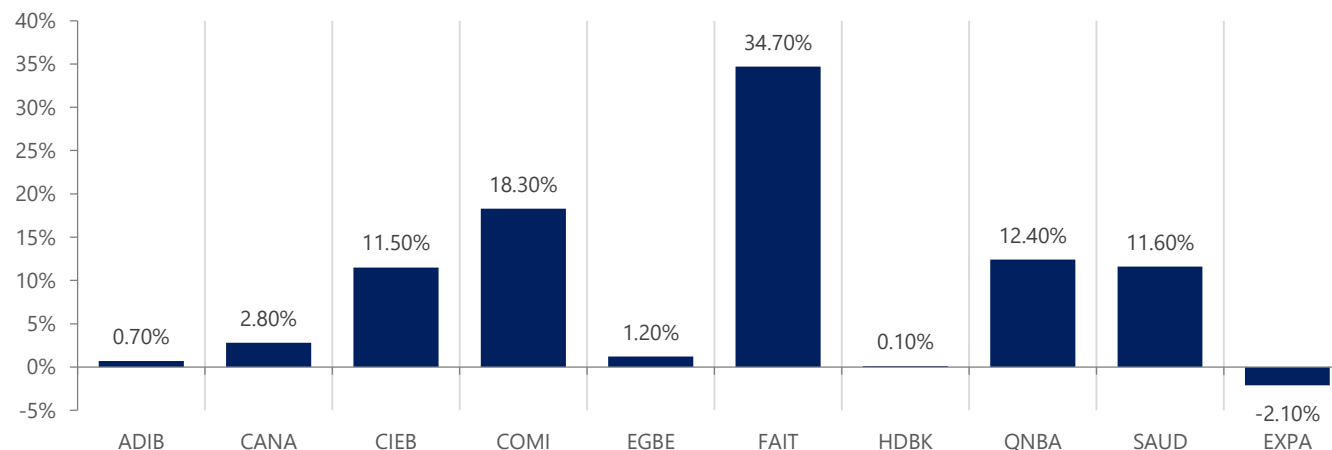


Figure 22: Net FCY position as a percentage of equity 2021



Source: Banks' financials, Prime Research.



M&A Activity: Cheap Becomes Cheaper

M&As to spur lending competition between Egyptian banks: Cheap and attractive valuations are always good reasons for M&As to find a good soil. For instance, **Arab Banking Corporation (Bank ABC)** acquired 100% of **BLOM Bank – Egypt**. Also, the Egyptian unit of **First Abu Dhabi Bank (FAB)** fully acquired **Bank Audi – Egypt**. The aforementioned deals came as a great expansion opportunity for the buyers, after the valuation of the Lebanese banks were affected by their economy. There is another reason for M&As. Since the CBE suspended issuing new banking licenses years ago, acquisitions has accelerated over time. As we have seen EFG Hermes Holding [**HRHO**] acquiring a 51% stake in state-owned **Arab Investment Bank (aiBank)**. We believe the ongoing M&A trend will cause competition to stiffen.

A potential merger in sight? With banks having to comply with the CBE’s EGP5bn minimum capital requirement, we could see potential mergers to do just that. The paid-in capital of both **CANA** and **SAIB** is below the CBE’s requirement, and both have the same major shareholder, i.e. **Arab International Bank (AIB)**. We would speculate that the parent bank might consider merging the two subsidiaries, thus creating a new stronger and complying banking entity.

EGP weakness to encourage more acquisitions: Given the recent EGP depreciation, which added luster to Egyptian equities, many strategic investors jumped to the opportunity. On the day of the depreciation, **Abu Dhabi Developmental Holding Co. (ADQ)** was reportedly interested in investing USD2bn to acquire state-held stakes in certain EGX-listed companies. The list included an 18% stake in **COMI** as well as an unidentified stake in Fawry [**FWRY**]. We believe other investors will follow after Egyptian assets became cheaper in USD terms.

Figure 23: Summary of latest M&A deals

Acquiring Entity	Target	Seller	Deal Implied P/B
Arab Banking Corporation (ABC)	BLOM Bank - Egypt	BLOM Bank - Lebanon	1.4x
First Abu Dhabi Bank	Bank Audi Egypt	Bank Audi - Lebanon	1.2x
EFG Hermes Holding [HRHO] / The Sovereign Fund of Egypt	aiBank	N/A*	0.6x
National Bank of Kuwait	National Bank of Kuwait - Egypt	Minority shareholders	1.0x
ADCB - UAE	ADCB - Egypt [UNBE]	Minority shareholders	1.0x
Average implied P/B			1.0x
Average selected EGX listed banks			0.7x

* The deal was accomplished through a capital increase.

Source: Prime Research.

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