

## The Causal Sequence

H1 2022 banking sector results overview

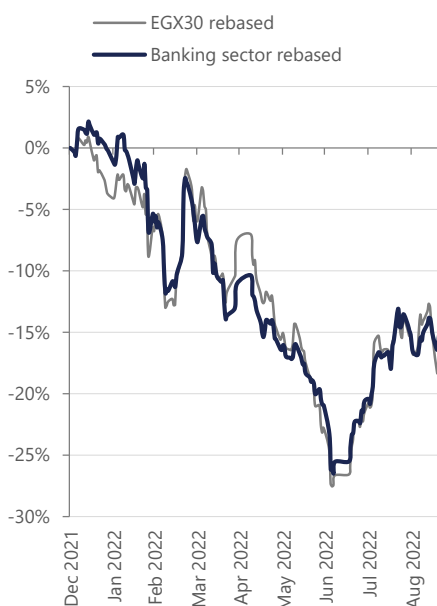
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### INDEX RELATIVE PERFORMANCE (YTD)



Source: EGX, Prime Research.

When we consider the performance of the Egyptian banking sector so far in 2022, we can directly see the chain of cause and effect with recent developments in the monetary environment affecting banks' allocation, profitability, and ALM strategies. The drastic competition coming from state-owned banks with high-yield CDs, and consequently the shift of liquidity, has highlighted how value in banks—at times of rising yields—mainly comes from the liability side rather than the asset portfolio.

In this note, we analyze EGX-listed banks' H1 2022 results with emphasis on Q2, putting the spotlight on top performers.

**Who played it better in H1 2022?** Generally speaking, all banks showed a very satisfying double-digit y/y earnings growth in H1 2022, thanks to higher yields. However, we note that Q2 2022 was generally weaker q/q in terms of operational strength and balance sheet growth. This was due in part to the share-eating 18% one-year CDs issued last March by state-owned banks, the full effect of which was felt in Q2 2022. Some banks' earnings slipped q/q in Q2 2022 due to a very high base effect, such as **FAIT** (-53%) and **COMI** (-17%). Both banks had witnessed an exceptional Q1 2022. On one hand, **FAIT** reported FX gains following the EGP depreciation. On the other hand, **COMI** booked gains on sale of financial investments.

For all banks, we note the following three obvious patterns:

- (1) **Provisioning normalization** after two consequent years of pandemic-induced sky-high provisions. The average CoR for EGX-listed banks in H1 2022 was -0.3% vs. -1.04% in 2021.
- (2) **Increasing investments in debt securities**, as banks tend to exploit increasing yields. This specific approach continued to be more evident in Q3 2022. Indeed, a recent 3-month T-Bill auction witnessed the highest bid-to-cover ratios of 11.4x compared to a ytd average of 2.4x.
- (3) **Restrained ytd deposit growth**, averaging 7% ytd, excluding **HDBK** for its deposits is of a special nature. This is half total market deposit growth of 14% ytd, which we attribute to the two large state-owned banks (**National Bank of Egypt** and **Banque Misr**).

We also note that Islamic banks struggled the most with a large increase in their cost of funds (CoF), for some of them had to modify their pricing to put a lid on their leaking deposits. **FAIT** is a case in point, having seen a material increase in its annualized CoF to 6.8% in H1 2022 from 4.9% in 2021.



**How small banks rode out the storm in Q2 2022:** In our view, out of the 10 EGX-listed banks, five small banks in terms of market cap stood out in Q2 2022, namely **EGBE**, **ADIB**, **SAUD**, **EXPA**, and **CANA**. Their median y/y earnings growth was 37% in Q2 2022, more than double the 18% y/y for the other five banks. This suggests that larger banks are more sensitive to changes in monetary policies, given their size and exposure. While smaller banks are riskier, we believe, they are more flexible to the same externalities. Within the small banks universe, **EXPA** witnessed a phenomenal y/y earnings growth of 117% in Q2 2022 in light of a very weak base.

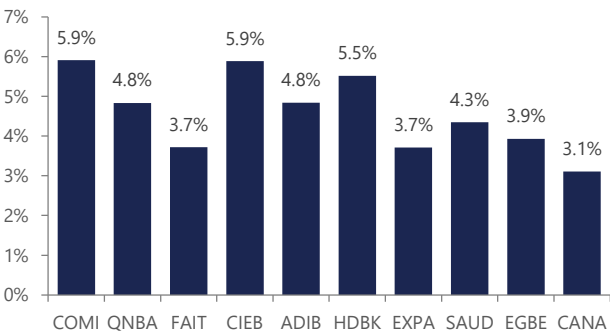
**Unusual times, unusual measures; look at RAROC:** While high return is usually associated with high risk, banks' biggest conundrum at these times of high uncertainty is to simultaneously maintain their risks and improve their returns. To properly analyze and compare banks' profitability, we need to use new measures to help us see better. The commonly-used performance metric to measure banks' profitability is **return on equity (ROE)**. However, it completely ignores risk, which leads us to another profitability measure that takes risk into account, namely **risk-adjusted return on capital (RAROC)**. RAROC is considered a modified version of ROE, adjusting both the nominator and denominator for risk. On the nominator side, net income is adjusted for cost of "excess capital" above the CBE requirements. On the denominator side, we use the economic capital which is the buffer banks must maintain to remain solvent and compliant with the CBE minimum requirements (i.e. 12.5% of risk-weighted assets). The higher the RAROC, the better; this means the bank makes better return on each unit of minimum capital. Normalizing profits by the amount of risk undertaken, RAROC exposes banks that are seemingly profitable but are excessively risky. The more risky assets the bank has, the lower its RAROC is relative to its ROE. A bank that with a lower RAROC than its ROE demonstrates a higher level of risk. For instance, **ADIB** has the highest negative spread (i.e. RAROC – ROE) of -4.2%, reflecting its lowest CAR in the market. On the contrary, a bank with a higher RAROC enjoys a controlled marginal risk. For instance, **COMI** has the highest positive spread of 3.7%, followed by **CIEB** with a spread of 3%. RAROC data are expressed in the follow-up charts starting on [Page 3](#).

**H2 2022 outlook:** For the remaining months of 2022, we expect more rate hikes of 100-200bps, with some voices calling for an imminent currency devaluation. Thus, we expect banks' strong performance to continue, especially for banks with a positive asset repricing gap, such as **COMI**, **CIEB**, and **QNBA**. Also, banks with a relatively bigger net long foreign currency position, such as **COMI** and **FAIT**, should perform well just like H1 2022. But for banks to make better use of higher yields, there is one caveat: no reissuance of high-yield CDs by state-owned banks. Otherwise, in the case of a USD/EGP overshooting, there will be no choice for state-owned banks but to re-issue high-yield CDs to counter dollarization.

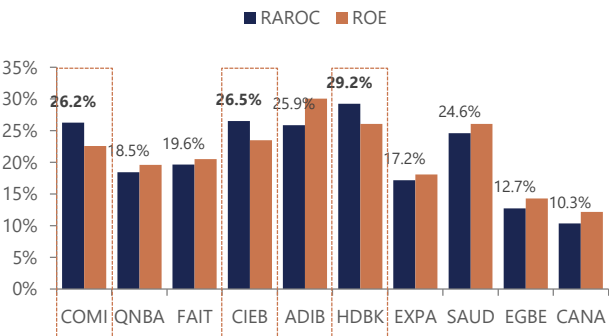


H1 2022 STORY IN CHARTS

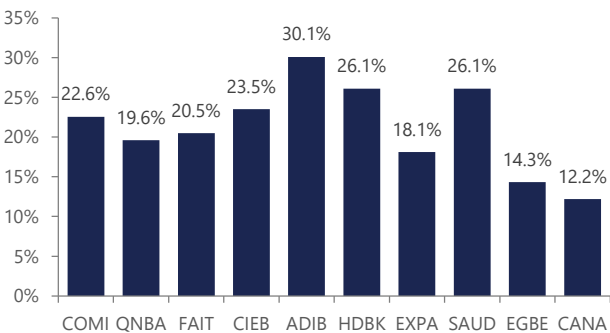
NIM (annualized)



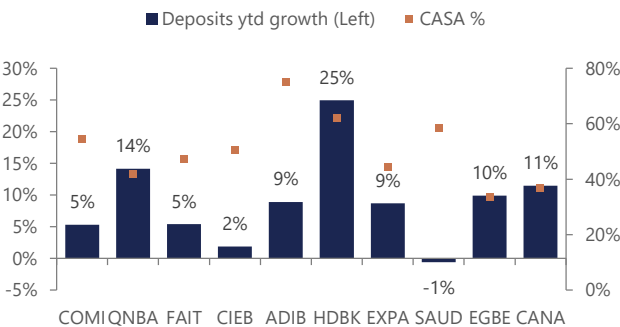
RAROC vs. ROE



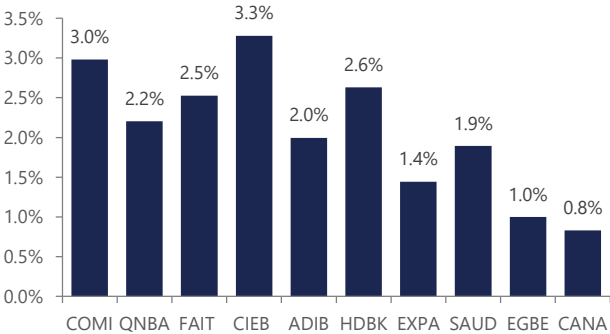
ROE (annualized)



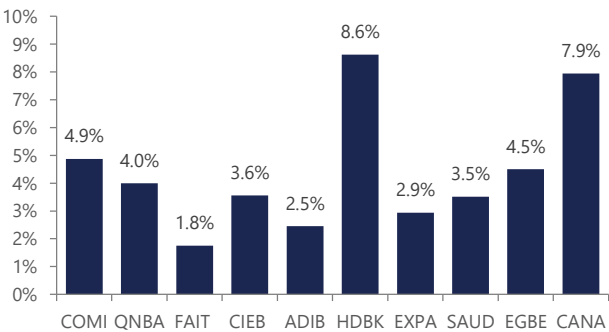
Deposits ytd growth



ROA (annualized)



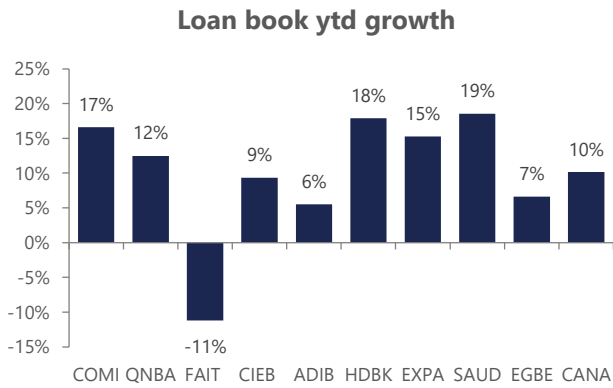
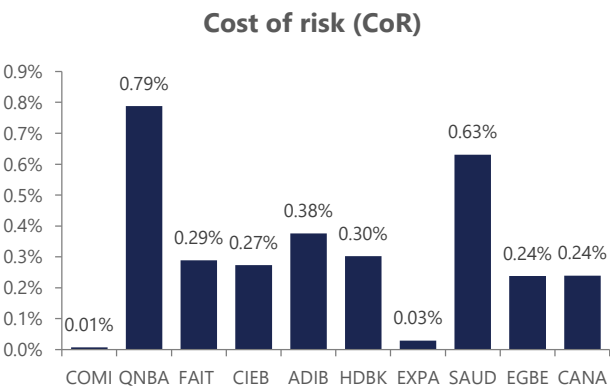
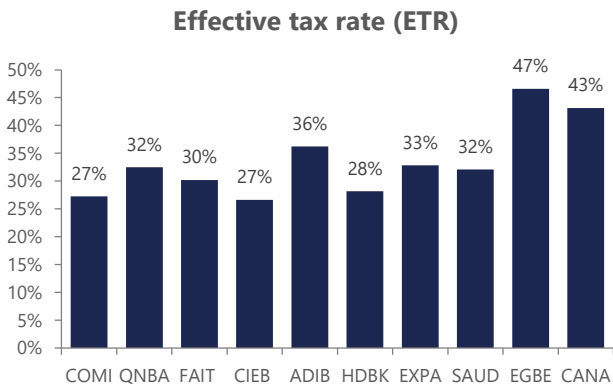
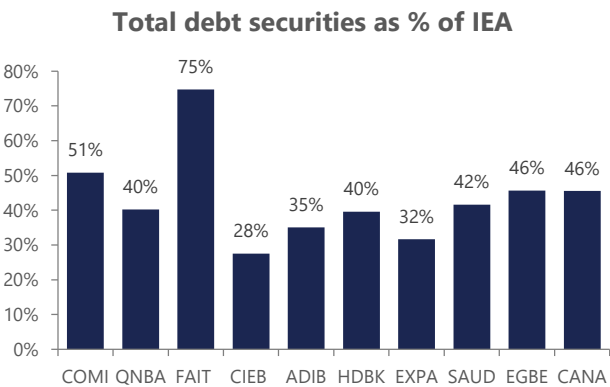
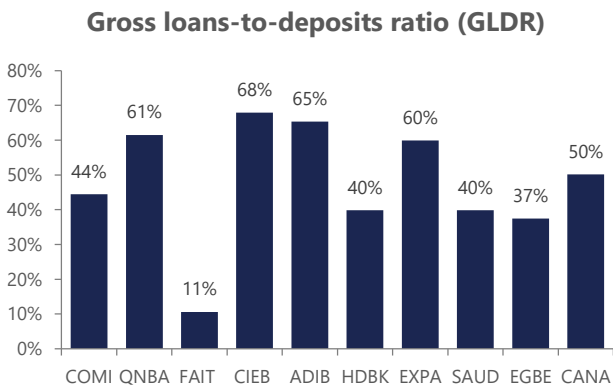
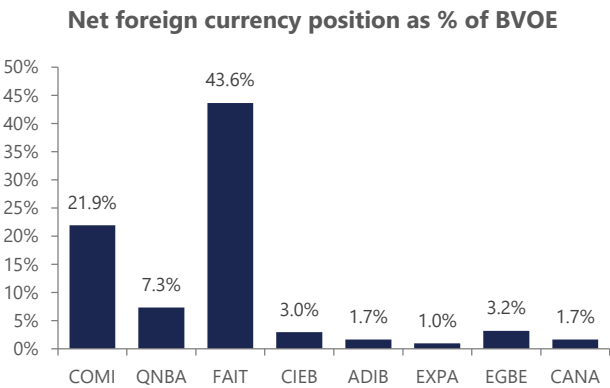
NPL ratio



Source: Bank reports.



H1 2022 STORY IN CHARTS (CONT'D)



Source: Bank reports.

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