

KINGDOM SECURITIES

Co-operative Bank of Kenya – Earnings Update Q1-2020

We give an **ACCUMULATE** recommendation on Co-operative Bank. We forecast the bank will ride the economic wave to a valuation of KES 14.33, a 12.8% gain from the close of KES 12.70 on May 21st, 2020. The bank posted a 2.9% gain in Profit Before Tax (PBT) and exceptional items from KES 5.09Bn in Q1-2019 to KES 5.24Bn in Q1-2020. Profit After Tax shrunk by 0.3% to KES 3.59Bn from KES 3.60Bn affected by a KES 121.65Mn loss from associate profits. EPS remained flat at 2.45. We expect a harder Q2-2020 with a recovery in towards end of 2020 due to the ongoing restructuring and cleansing of the loan book.

- Net Interest Income (NII) closed the first quarter at KES 7.52Bn, 8.5% jumped from KES 6.93Bn. Interest income was up 4.5% boosted by 5.2% upward tick from interest from loans and advances which was shouldered by a 9.8% increase in loan book.
- Income expense eased by 4.5% on lower interest expense benefiting from funding mix. This helped ease cost of average fund, including borrowing, to 3.4% from 3.8% y-o-y. NII contribution to total income dropped to 60.1% from 62.3%.
- Growth in digital loan product, MCo-op Loan, pushed Non-Funded Income (NFI) to KES 4.98Bn, 19.0% y-o-y increase from KES 4.19Bn. NFI contribution jumped to 39.9% from 37.7% y-o-y.
- Growth in provision from the expanding loan book pushed expenses up by 20.6% to KES 7.26Bn from KES 6.02Bn for a Cost to Income ratio of 58.1% from 54.2%. A 25.0% jump in staff cost caused expenses excluding provisions to increase by 15.2%. This led to CTI excluding provisions to increase by 122bps to 50.9% from 49.7%.
- Low yields from government funding saw the bank growth in government security grow at a slower pace of 11.5% in Q1-2020 compared to a growth of 38.6% in Q1-2019.
- The bank loan book grew by 9.8% as it continues to favor Personal Banking whose Q1-2020 proportion went up to 40.9% from 35.7% in Q1-2019 while reducing its portion on Corporate and Mortgage books to 23.3% and 12.4% from 25.3% and 14.3% respectively over the same period.
- Asset base was grown through deposit mobilization and borrowing which saw debt to equity ratio increase from 32.6% in Q1-2019 to 33.4% in Q1-2020 with cost of risk increasing to 1.4% from 0.8% y-o-y. The borrowing levels aided advances to deposit (AD) ratio to 81.3% from 79.2% in Q1-2020.
- Key ratio – Return on average Assets (ROaA) and Return on average Equity (ROaE) deteriorated to 3.2% and 18.5% from 3.5% and 20.5% on a faster growth in assets shareholders' fund compared to PAT. Cost of risk (CoR) worsened to 1.4% due to a 15.5% increase in borrowing. Net Interest Margins (NIM) on earning assets marginally eased to 7.3% from 7.4% while NIMs on loans increased to 8.1% from 7.6%.
- Our Outlook - We forecast a weak Q2-2020 on deteriorating economy due to the lockdown and slowdown in business activity. The bank is in talks with clients in restructuring their loans. With the current economic environment, the quality of the loan book will be tested with a close eye needed on the digital loans which are unsecured and tend to have a high NPL levels with industry average at 22.5%.

Recommendation: **ACCUMULATE**
Bloomberg Ticker: **COOP KN**

Share Stats	
Current Price (KES)	12.70
Valuation	14.33
Potential Upside/Downside	12.8%
Issued shares Mn	5,867.18
Market Cap (KES Mn)	74,513.13
Market Cap (USD Mn)	697.69
EPS	2.46
PE	5.16
PB	0.89

Profit and Loss (KES Mn)			
	Q1 2019	Q1 2020	%Δ
Interest Income	10,086	10,540	4.5%
Interest Expense	3,159	3,021	-4.4%
NII	6,928	7,519	8.5%
NFI	4,189	4,984	19.0%
Total Income	11,116	12,502	12.5%
Provisions	501	900	79.5%
Expenses	6,024	7,263	20.6%
Expense excl Provisions	5,522	6,363	15.2%
PBT	5,113	5,118	0.1%
PAT	3,599	3,589	-0.3%
EPS	2.45	2.45	0.0%

Balance Sheet (KES Mn)			
	Q1 2019	Q1 2020	%Δ
Investment Securities	106,109	117,150	10.4%
Loans and Advances	251,629	276,173	9.8%
Total Assets	425,674	470,410	10.5%
Customer Deposit	317,770	339,567	6.9%
Shareholders' Equity	74,175	83,545	12.6%

Key Ratios		
	Q1 2019	Q1 2020
NII Contribution	62.3%	60.1%
NFI Contribution	37.7%	39.9%
CTI	54.2%	58.1%
CTI ex Provisions	49.7%	50.9%
AD	79.2%	81.3%
Investment to Assets	24.9%	24.9%
Loans to Assets	59.1%	58.7%
ROaA	3.5%	3.2%
ROaE	20.5%	18.5%
Cost of Risk	0.8%	1.4%
NIM	7.4%	7.3%

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Recommendation Guide:

Analysts' stock ratings are defined as follows:

- **Buy** – A buy rating reflects 1) An analyst has a bullish conviction on a stock 2) A 30% or greater expected return.
- **Accumulate** – An accumulate rating reflects 1) An analyst has a lesser bullish conviction on a stock 2) Expected return falls between 10% and 30%.
- **Hold** – A hold rating reflects 1) An analyst has a neutral conviction (lack of bullish or bearish conviction) on a stock 2) Expected return falls within the range of 5% to 10%.
- **Speculative Buy** – A speculative buy rating reflects 1) An analyst has a bullish conviction accompanied by a substantially higher than normal risk 2) Expected return falls above 10%.
- **Sell** – A sell rating reflects 1) An analyst has a bearish conviction on a stock 2) Expected return falls below 5%.

*Expected Return (ER) represents the sum total of both capital appreciation and the dividend yield.

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