KINGDOM SECURITIES

The Co-operative Bank of Kenya

Earnings Update – H1-2022

The Co-Op Bank of Kenya – Strong NFI Growth

The Co-operative Bank of Kenya posted a profit before tax of KES 15.64Bn, an all-organic growth of 48.6% y-y, from KES 10.52Bn in H1-21. Profit after tax (PAT) grew buy 60.6% y-y to KES 11.83Bn from KES 7.37Bn over the period. The performance was supported by a 28.8% y-y surge in non-funded income (NFI) and a 19.6% y-y dip in loan loss provisions. PAT was further supported by a lower effective tax rate (ETR) of 24.4% compared to an ETR of 30.0% in H1-21. The bank has remained conservative on lending with a 9.6% y-y loan book growth compared to an average of 19.3% of the Kenyan subsidiaries of its key competitors.

EPS was at 1.95 for an annualize EPS of 3.90 for a PE of 3.1x and a PB of 0.7x compared to sector PE of 5.9x and PB of 1.0x.

We retain an ACCUMULATE recommendation at a value of KES 15.60, a 29.5% upside compared to KES 12.05 as at close of Friday August 26th, 2022.

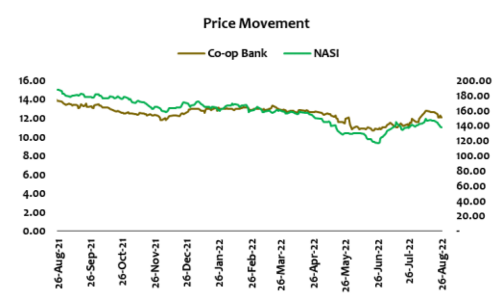
- The Group net interest income was up 11.8% to KES 7.52Bn from KES 7.13Bn in H1-21. This was due to a 10.1% growth in interest income and a slower growth in interest expense of 5.5%. y-y. in Q2-22, NII grew by 3.0% with interest expense overshooting interest oncome to grow at 7.2% against 4.1% respectively. NII contributed 31.3% in H1-22 compared to 64.6% in H1-21.
- A 11.9% y-y increase in interest from government securities helped growth interest income by 10.1% y-y to KES 28.57Bb from KES 25.96Bn. Performance on the return on government securities was supported by improved yields to 10.7% from 10.2% in H1-21 with net investments increasing by 0.8% y-y. Income from loans and advances was 9.4% y-y higher on a 9.6% y-y expansion on net loan book and while yields on loans remained near flat at 11.6% from 11.5% in H1-21.
- Interest expense was up 5.5% y-y from KES 7.13Bn to KES 7.52Bn as interest expense on deposits grew by 5.9% y-y on a 3.8% growth in customer deposits and a flat 3.3% cost of deposits.

  The quarter saw interest on deposits rise by 6.9% q-q with deposit drive bringing in an additional KES 12.21Bn.
- Non-Funded income increased by 28.8% y-y to KES 13.30Bn from KES 10.32Bn boosted by e-credit business under Fees and commissions on loans and advances which were up 103.7% y-y after restructuring lending criteria – especially MSME, improvement on system and marketing the product to internal clients. Foreign exchange trading income was up 48.1% y-y gaining from tight demand and increase in global trade. NFI contributed 38.7%, up from 35.4% in H1-21.

  Quarterly basis, NFI was up 7.5% q-q boosted by a 55.7% q-q increase in foreign trading income and a 13.0% q-q rise in fees and commission income from loans and advances.

Recommendation:	ACCUMULATE
Bloomberg Ticker:	COOP KN
Share Stats	
Valuation	15.60
Current Price	12.05
Upside / Downside	29.5%
3-Months Av	11.46
6-Months Av	12.04
52-Week Av	12.45
52 Week High - Low	13.95 - 10.70
Issued shares Mn	5,867.17
Free Float	35.4%
Market Cap (KES Mn)	70,699.46
Market Cap (USD Mn)	589.62
EPS (annualized)	3.90
PE	3.1x
PB	0.7x
DPS	1.00
DPS Yield	8.3%
Payout	25.6%
Total Return	37.8%

Price Movement		
Period	Co-op Bank	NASI
26-Aug-22	12.05	138.79
W-W	-4.4%	-5.1%
M-M	9.5%	1.6%
Y-T-D	-7.3%	-16.9%
Y-Y	-13.0%	-25.9%



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- Operating expenses were marginally up 0.5% y-y to KES 18.80Bn from KES 18.70Bn. The slow increase was due to a 19.6% drop in loan loss provisions taking advantage of earlier aggressive provisions. Cost to income (CTI) dipped to 54.7%, from 64.1% in H1-21. Quarterly provisions were up 16.7% q-q which pushed total operating expenses up 8.3% q-q.
- Excluding provisions, expenses were up 6.3% y-y to KES 15.45Bn from KES 14.54Bn as staff cost rose by 8.6% on annual salary adjustments and other operating expenses up 13.6% on business growth and branch expansion. On the quarter, the operating expenses less provisions were up 6.6% q-q affected by a 30.0% q-q rise in other operating expense. CTI excluding provisions dipped to 45.0% from 49.9%.

Balance Sheet

- Total assets saw KES 30.91Bn added on KES 573.01Bn for a 5.4% y-y growth to KES 603.92Bn.
- Customer deposits were up 3.8% y-y to KES 423.03Bn from KES 407.69Bn as the bank managed to boost deposits by KES 15.35Bn.
- Investments in securities were up marginally to KES 184.93Bn, a 0.8% rise from 183.38Bn as the line added KES 1.55Bn. The ratio to total assets eased to 30.6% from 32.0% in H1-21.
- Loan book expanded by 9.6% as KES 28.87Bn added to close the half at KES 330.06Bn from KES 301.19Bn. Loans to assets increased to 54.7% from 52.6%. Advances to deposits increased to 78.0% from 73.9%.
- Net borrowing declined by 6.9% y-y to KES 41.36Bn from KES 44.43Bn as the det to equity ratio dipping by to 42.6% from 48.0%. During Q2-22, the bank paid a net Kes 1.92Bn on borrowing.
  The statutory ratio was strong, however, there will be need for additional borrowing to keep the ratios high as deposit mobilization and cost management remains an issue.
- Shareholders' fund was up 4.7% y-y to KES 96.99Bn from KES 92.60Bn with a 16.9% y-y growth in retained earnings. Dividend payment saw shareholders' funds decline by 6.1Bn in Q2-22.

Key Ratio

- Cost of funds remained flat eased to 3.3% from 3.4% in H1-21, while improvement in yields from interest earning assets to 11.0% from 10.7% saw net interest margins (NIMs) improve from 7.3% in H1-21 to 7.7%.
- Return on average assets (ROaA) shot to 4.0% in H1-22 from 2.7% in H1-21 while return on average equity (ROaE) jumped to 23.9% from 16.0% during the period. This was boosted by faster growing PAT compared to relevant balance sheet items.
- The lenders 3C strategy of Connect Collet Cure and stringent lending policies aided in cutting NPLs which declined to 13.7% from 14.6% in H1-21.
- The lower provisions and fattening loan book saw cost of risk (CoR) edge down to the target level of 2.0% from 2.8% in H1-21.
- NPLs declined to 13.7% from 14.6%. The H1-22 levels are below the Kenyan industry H1-22 NPLs of 14.7%. This was supported by a slower growth of 2.7% y-y on total non-performing loans compared to net loan book growth of 9.6%.

Outlook

- A 16.7% q-q growth in provisions is a signal of a potential rise in CoR while management of NPLs will continue to see a single digit growth in bank net loan book.
- The lenders strategy on e-credit will continue to support NFIs towards a long-term target of 40.0%. The Group targets to lend KES 10.0Bn per month on e-credit.
- We don't foresee any regional expansion on the group as it maintains the need to consolidate and grow the Kenyan business.

Income Statement (KES Mn)	H1-2021	H1-2022	%Δ Y-Y	Q1-2022	Q2-2022	%Δ Q-Q
Interest Income	25,960	28,574	10.1%	14,001	14,573	4.1%
Interest Expense	7,128	7,519	5.5%	3,629	3,890	7.2%
NII	18,832	21,055	11.8%	10,373	10,683	3.0%
NFI	10,324	13,299	28.8%	6,408	6,890	7.5%
Total Income	29,155	34,354	17.8%	16,781	17,573	4.7%
Provisions	4,158	3,345	-19.6%	1,544	1,801	16.7%
Expenses	18,696	18,799	0.5%	9,024	9,775	8.3%
Expense excl Provisions	14,538	15,454	6.3%	7,480	7,974	6.6%
PBT	10,524	15,644	48.6%	7,789	7,854	0.8%
PAT	7,366	11,828	60.6%	5,835	5,993	2.7%
EPS (annualized)	1.26	1.95	54.8%	0.99	0.96	-3.0%

Balance Sheet (KES Mn)	H1-2021	H1-2022	%Δ Y-Y
Investment Securities	183,376	184,930	0.8%
Loans and Advances	301,191	330,056	9.6%
Total Assets	573,009	603,922	5.4%
Customer Deposit	407,686	423,031	3.8%
Borrowings	44,428	41,357	-6.9%
Shareholders' Equity	92,599	96,988	4.7%

NPLs KES Mn	H1-2021	H1-2022	%Δ Y-Y
Gross NPLs	50,847	51,187	0.7%
Total NPL	44,041	45,217	2.7%

Key Ratios	H1-2021	H1-2022
NII Contribution	64.6%	61.3%
NFI Contribution	35.4%	38.7%
CTI	64.1%	54.7%
CTI ex Provisions	49.9%	45.0%
Yield on Loans	11.5%	11.6%
Yield on Government Securities	10.2%	10.7%
Cost of Deposit	3.3%	3.3%
Cost of Funds	3.4%	3.3%
Net Interest Margin	7.3%	7.7%
ROaA	4.0%	4.0%
ROaE	23.9%	23.9%
Gross NPL to Net Loans	14.6%	13.7%
Cost of Risk	2.8%	2.0%
Advance to Deposit	73.9%	78.0%
Advance to Deposit and Debt	66.6%	71.1%
Investment to Assets	32.0%	30.6%
Loans to Assets	52.6%	54.7%
Debt to Equity	48.0%	42.6%

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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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