

Growth on Branch Expansion and New Core Banking System

Co-operative Bank of Kenya posted KES 16.41Bn in profits before tax (PBT), a 7.4% y-y growth compared to KES 15.28Bn in H1-22. The lender reported a 5.9% y-y rise in profits after tax (PAT) to KES 12.14Bn from KES 11.48Bn over the same period. The bottom line was supported by a 12.0% y-y increase in interest income and a 14.4% thinning in loan loss provisions. PAT was lower affected by a higher effective tax rate of 26.0% compared to 25.0% in H1-22.

Earnings per share increased to 6.7% while book value was 18.5 with a PE of 3.0x and PB of 0.7x compared to industry PE of 3.61x.

We advise our investors BUY the stock at the current price of KES 11.70, which has a potential y-y upside 7.5% as we expect the board of directors to retain the KES 1.50 dividend for FY-23 for a potential total return of 20.3%

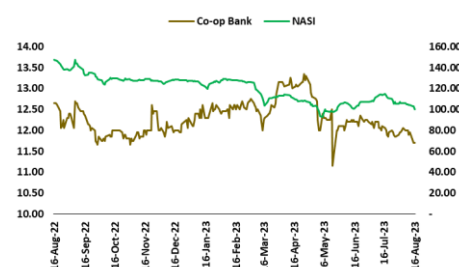
- Net interest income was up 2.3% y-y with the upside coming from a 12.0% y-y growth in interest income which grew slower compared to a jump of 38.9% y-y on interest expense. On quarterly basis, Q2-23 NII was flat at KES 10.77Bn as interest income was up 5.5% q-q and interest expense growing by 17.5% q-q. NII contribution to total income was 60.9%, a lower level compared to 61.3% in H1-22.
- Interest income stood at KES 31.99Bn, 12.0% growth from KES 28.57Bn in H1-22. The income growth was supported by a 13.8% y-y growth in interest from loans and advances due to a 10.7% y-y growth in net loan book while yields from loans and advances were up to 11.9% from 11.6%. Return from investment in government securities improved by 6.7% y-y as yield went to 11.5% from 10.7% over the period. The bank expanded investment in government securities book by 2.9% with little investments due to the rising yields. Yields on assets stood at 11.5% from a low of 11.0% in H1-22.
- During the quarter, interest income was up 5.5% with income from loans and advances growing by 9.8% q-q while yield from government securities were up by 5.5% q-q.
- Interest expenses were affected by the rising CBR rate leading to expensive deposits. Interest expenses increased by 38.9% y-y to KES 10.44Bn from KES 7.52Bn. Expense on deposits were up 22.7% y-y pushing cost of deposits up to 3.7% from 3.3% while deposit from customers closed up 2.2% y-y. A 11.8% y-y increase in borrowing to support bank operation saw the cost of borrowing increase by 181.3% y-y. The overall cost of funds was up to 4.4% from 3.3% in H1-22 cutting the net interest margin to 7.0% in H1-23 from 7.7% in H1-22.
- The quarter saw interest expenses up 17.7% due to a 10.7% increase in interest expense on deposits and a 67.1% jump online containing cost of borrowing as the lender saw customer liabilities and borrowing increase by 44.12Bn and 10.97Bn in Q2-23.
- Non-Funded Income grew by 4.0% y-y to KES 13.82Bn from KES 13.30Bn. The levels were buoyed by 8.4% increase in overall fees and commission income. Expansion in net loan book and demand for credit saw fees and commission income from loans and advances improve by 13.3% y-y. The foreign exchange trading income

Earnings Update – H1-2023

| Recommendation: | BUY |
|---------------------|---------------|
| Bloomberg Ticker: | COOP KN |
| Share Stats | |
| Current Price | 11.70 |
| 3-Months Av | 12.06 |
| 6-Months Av | 12.38 |
| Y-T-D Av | 12.39 |
| 52-Week Av | 12.27 |
| 52 Week High - Low | 13.35 - 11.15 |
| Issued shares Mn | 5,867.17 |
| Free Float | 35.4% |
| Market Cap (KES Mn) | 68,645.94 |
| Market Cap (USD Mn) | 476.56 |
| EPS (LTM) | 3.85 |
| PE | 3.0x |
| BVPS | 18.5x |
| PB | 0.6x |

| Price Movement | | |
|----------------|------------|--------|
| Period | Co-op Bank | NASI |
| 16-Aug-23 | 11.70 | 100.02 |
| 3-Months Av | 12.06 | 105.51 |
| 6-Months Av | 12.38 | 109.13 |
| Y-T-D Av | 12.39 | 112.60 |
| 52-Week Av | 12.27 | 119.68 |
| 52-High | 13.35 | 147.27 |
| 52-Low | 11.15 | 93.04 |

| Price Return | | |
|--------------|------------|--------|
| Period | Co-op Bank | NASI |
| 16-Aug-23 | 11.70 | 100.02 |
| 3-Months | -4.9% | 3.3% |
| 6-Months | -6.4% | -21.7% |
| Y-T-D | -3.3% | -21.5% |
| 52-Week | -7.5% | -32.1% |



Willis Nalwenge CFA
Lead Research Analyst

+254 711 049 047

[wnalwenge@co-opbank.co.ke](mailto:wналwenge@co-opbank.co.ke)

declined by 10.0% y-y. NFI Contribution to total income improved to 39.1% from 38.7% 90bps below lenders target of 40.0%.

- The quarter saw NFI thin by 5.3% with fees and commission income from loans and advances declining by 15.7% q-q and the foreign exchange trading income declined by 40.1%.
- Operating expenses were marginally down by 0.1% y-y to KES 19.14Bn from 19.15Bn driven by a 14.4% decline in loan loss provisions and 10.0% drop in other expenses. Pressure came from a 12.6% y-y rise in staff cost due to the expansion program which saw the number of branches increase to 191 from 184 at the end of 2022. Cost to Income (CTI) eased to 54.1% from 55.8% in H1-22. Excluding provision, expenses increased by 2.9% to KES 16.27Bn from KES 15.81Bn with CTI flat at 46.0%.
- Quarterly, total expenses were down by 5.0% on a 13.2% q-q drop loan loss provision and 14.5% q-q drop in other expenses with staff costs increasing by 0.9% while expenses excluding provisions thinned by 3.5% q-q.

Balance Sheet

- The balance sheet saw customer deposit grow by 9.7% y-y to KES 463.87Bn from KES 423.03Bn. The quarter saw KES 44.12Bn added to the liability line.
- Total assets expanded by 10.1% y-y to KES 664.95Bn from KES 603.92Bn.
- The deposit drive aided with loan book expansion with the net book growing by 10.7% y-y to KES 365.39Bn from KES 330.06Bn with Q2-23 adding KES 5.28Bn in net loans. The levels were slower than CBK reported credit growth of 13.6% as of May 2023 and Private Credit Growth of 12.2% in June 2023. The advances to deposit ratio improved to 78.8% from 78.0%. The ratio of net loan book to total assets improved to 54.9% from 54.7%.
- Change in tactic saw a slowdown in investment in government securities with the asset line expanding 2.9% y-y to KES 190.25Bn from KES 184.93Bn. This was despite raising yields with the lender growing it held to maturity book by 9.3% y-y. The asset line to total asset left the ratio at 28.6% down from 30.6% in H1-22.
- The bank recorded KES 59.37Bn in borrowings, a 43.6% y-y growth from KES 41.36Bn on expansion lending to MSME program. The quarter saw a total of KES 10.98Bn added to borrowing line leaving debt to equity ratio at 54.7% from 42.6%.
- Shareholders' equity increased to 11.9% y-y to KES 108.57Bn from KES 96.99Bn due to a 15.2% y-y increase in retained profits.
- Gross non-performing loans (NPLs) increased by 14.2% to KES 58.44Bn from KES 51.19Bn while total NPLs were up by 15.4% y-y to KES 52.18Bn from KES 45.22Bn. The levels saw NPL ratios increase to 14.3% from 13.7% in H1-22 and lower to industry gross NPL of 14.5% seen in June 2023.

Key Ratios

- Profitability ratio saw return on average assets at 3.8% against 3.9% in H1-22 and Q1-23 while return on average equity eased to 22.4% from 23.2% in H1-22 but better than 22.1% in Q1-23. The H1-23 performance was affected by faster growth in assets lines.
- A decline in loan loss provision saw cost to risk ease to 1.6% from 2.0% in H1-22 and 1.7% in Q1-23.

Outlook

- The lender continues with branch expansion to be able to serve its clients while the introduction of a new system will enable them to serve clients through alternative channels.
- Introduction of new products while growing its e-credit clients with the support of the new system remains key.
- Positioning itself with the growing sectors of the economy, especially in infrastructure development, agriculture supported by favorable weather and government subsidies in farming inputs.

| Income Statement (KES Mn) | H2-2022 | H2-2023 | %Δ Y-Y | Q1-2023 | Q2-2023 | %Δ Q-Q |
|---------------------------|---------------|---------------|-------------|--------------|--------------|--------------|
| Interest Income | 28,574 | 31,990 | 12.0% | 15,570 | 16,420 | 5.5% |
| Interest Expense | 7,519 | 10,444 | 38.9% | 4,798 | 5,646 | 17.7% |
| NII | 21,055 | 21,547 | 2.3% | 10,773 | 10,774 | 0.0% |
| NFI | 13,299 | 13,824 | 4.0% | 7,099 | 6,725 | -5.3% |
| Total Income | 34,354 | 35,371 | 3.0% | 17,872 | 17,499 | -2.1% |
| Provisions | 3,345 | 2,863 | -14.4% | 1,532 | 1,330 | -13.2% |
| Expenses | 19,159 | 19,137 | -0.1% | 9,815 | 9,321 | -5.0% |
| Expense excl Provisions | 15,814 | 16,274 | 2.9% | 8,283 | 7,991 | -3.5% |
| PBT | 15,284 | 16,407 | 7.4% | 8,149 | 8,258 | 1.3% |
| PAT | 11,468 | 12,141 | 5.9% | 6,111 | 6,030 | -1.3% |
| EPS | 1.95 | 2.08 | 6.7% | 1.04 | 1.04 | 0.0% |

| Balance Sheet (KES Mn) | H2-2022 | H2-2023 | %Δ Y-Y |
|------------------------|---------|---------|--------|
| Investment Securities | 184,930 | 190,247 | 2.9% |
| Loans and Advances | 330,056 | 365,388 | 10.7% |
| Total Assets | 603,922 | 664,946 | 10.1% |
| Customer Deposit | 423,031 | 463,874 | 9.7% |
| Borrowings | 41,357 | 59,369 | 43.6% |
| Shareholders Equity | 96,988 | 108,567 | 11.9% |

| NPLs KES Mn | H2-2022 | H2-2023 | %Δ Y-Y |
|-------------|---------|---------|--------|
| Gross NPLs | 51,187 | 58,436 | 14.2% |
| Total NPL | 45,217 | 52,176 | 15.4% |

| Key Ratios | H2-2022 | H2-2023 | %Δ Y-Y |
|--------------------------------|---------|---------|--------|
| NII Contribution | 61.3% | 60.9% | -0.4% |
| NFI Contribution | 38.7% | 39.1% | 0.4% |
| CTI | 55.8% | 54.1% | -1.7% |
| CTI ex Provisions | 46.0% | 46.0% | 0.0% |
| Yield on Loans | 11.6% | 11.9% | 0.4% |
| Yield on Government Securities | 10.7% | 11.5% | 0.9% |
| Cost of Deposit | 3.3% | 3.7% | 0.5% |
| Cost of Funds | 3.3% | 4.4% | 1.1% |
| Net Interest Margin | 7.7% | 7.0% | -0.7% |
| ROaA | 3.9% | 3.8% | -0.1% |
| ROaE | 23.2% | 22.4% | -0.8% |
| Gross NPL to Net Loans | 13.7% | 14.3% | 0.6% |
| Cost of Risk | 2.0% | 1.6% | -0.5% |
| Advance to Deposit | 78.0% | 78.8% | 0.7% |
| Advance to Deposit and Debt | 71.1% | 69.8% | -1.2% |
| Investment to Assets | 30.6% | 28.6% | -2.0% |
| Loans to Assets | 54.7% | 54.9% | 0.3% |
| Debt to Equity | 42.6% | 54.7% | 12.0% |

Terms of Use – Disclaimer:

This research report has been prepared by Kingdom Securities Limited and is for information purposes only. This research report should not be construed as an offer or solicitation to sell or buy any investment or product. Any opinions expressed herein reflect the analyst's judgment at the date of publication and neither Kingdom Securities Limited, nor any of its affiliates or employees accepts any responsibility in respect of the information or recommendations contained herein. Unless otherwise stated, the opinions contained in this material are as of the date indicated and are subject to change at any time without prior notice. Past performance is not a guarantee or indication of future results.

The information and opinions contained in this Material have been derived from sources believed to be reliable and in good faith or constitute Kingdom Securities' judgement as at the date of this research, but no warranty is made as to their accuracy and any opinions are subject to change and may be superseded without notice. In no circumstances will Kingdom Securities or its employees be liable to you for any errors or omissions in this report or for any losses you may incur in following any recommendations in the report. Kingdom Securities is a Subsidiary of Co-operative Bank of Kenya.

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 of both capital appreciation and the dividend yield.

Kingdom Securities Ltd – A subsidiary of Co-operative Bank Limited.

Co-operative Bank House- 5th Floor, P.O Box 48231 - 00100 Nairobi, Kenya

Office: 0711049540/0711049956

Email: info@kingdomsecurities.co.ke

Research Department

| | |
|----------------------|------------------|
| Willis Nalwenge, CFA | +254 711 049 047 |
| Shadrack Manyinsa | +254 711 049 956 |

Sales Team

| | |
|---------------|------------------|
| Edgar Martim | +254 711 049 534 |
| Alfred Too | +254 711 049 330 |
| Asena Moffat | +254 711 049 663 |
| Ashley Odundo | +254 711 049 195 |
| Gloria Ohito | +254 711 049 993 |

Client Service and Operations

| | |
|----------------|------------------|
| Joab Kiprono | +254 711 049 528 |
| Purity Malombe | +254 711 049 729 |