Co-operative Bank of Kenya Ltd – FY'2021
18th March, 2022

Below is a summary of Co-operative Bank of Kenya Ltd FY'2021 performance:

Balance Sheet Items (Kshs bn)	FY'2020	FY'2021	y/y change
Government Securities	161.9	184.1	13.7%
Net Loans and Advances	286.6	310.2	8.2%
Total Assets	**536.9**	**579.8**	**8.0%**
Customer Deposits	378.6	407.7	7.7%
Total Liabilities	444.9	479.0	7.7%
Shareholders' Funds	**90.7**	**100.2**	**10.5%**

Balance Sheet Ratios	FY'2020	FY'2021	% points y/y change
Loan to Deposit Ratio	75.7%	76.1%	0.5%
Return on average equity	12.5%	17.3%	4.8%
Return on average assets	2.2%	3.0%	0.8%

Income Statement (Kshs bn)	FY'2020	FY'2021	y/y change
Net Interest Income	36.3	41.0	12.9%
Non-Interest Income	17.5	19.4	11.0%
Total Operating income	**53.8**	**60.4**	**12.3%**
Loan Loss provision	(8.1)	(7.9)	(2.3%)
Total Operating expenses	(39.4)	(38.1)	(3.3%)
Profit before tax	14.3	22.6	58.6%
Profit after tax	**10.8**	**16.5**	**53.0%**
Earnings per share (Kshs)	**1.6**	**2.4**	**53.0%**

Income Statement Ratios	FY'2020	FY'2021	% points y/y change
Yield from interest-earning assets	11.4%	11.5%	0.1%
Cost of funding	3.0%	3.2%	0.2%
Net Interest Spread	8.4%	8.3%	(0.1%)
Net Interest Income as % of operating income	67.5%	67.9%	0.4%
Non-Funded Income as a % of operating income	32.5%	32.1%	(0.4%)
Cost to Income	73.2%	63.0%	(10.2%)
Cost to Income Ratio without provisions	58.1%	49.9%	(8.2%)
Cost to Assets	5.8%	5.2%	(0.6%)
Net Interest Margin	8.5%	8.0%	(0.5%)

Capital Adequacy Ratios	FY'2020	FY'2021
Core Capital/Total deposit Liabilities	19.1%	19.6%
Minimum Statutory ratio	8.0%	8.0%
Excess	**11.1%**	**11.6%**
Core Capital/Total Risk Weighted Assets	15.4%	15.6%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.9%**	**5.1%**
Total Capital/Total Risk Weighted Assets	16.9%	17.2%
Minimum Statutory ratio	14.5%	14.5%
Excess	**2.4%**	**2.7%**
Liquidity Ratio	52.2%	53.8%

Minimum Statutory ratio	20.0%	20.0%
Excess	**32.2%**	**33.8%**
Adjusted Core Capital/Total Risk Weighted Assets	13.9%	12.8%
Adjusted Total Capital/Total Risk Weighted Assets	15.4%	14.3%

Key Highlights – FY'2021

- Co-operative Bank of Kenya revealed it had taken Kshs 17.2 bn in international funding to support MSMEs in 2021. The disclosed loan facilities include:
  a) On 18th January 2021, Co-operative Bank announced it had received a USD 75.0 mn (Kshs 8.6 bn) loan from the International Finance Corporation (IFC) to facilitate lending to MSMEs and businesses undertaking climate-friendly projects. The loan, which has a 7-year repayment period will also help match the bank's assets-liabilities match, with long term loans being financed by long term debt,
  b) On 11th February 2021, Co-operative Bank also received a USD 15.0 mn (Kshs 1.7 bn) loan from Swedfund to enhance the bank's ability to lend to SMEs and increase their access to funding particularly in the midst of a pandemic,
  c) On 30th March 2021, the bank announced it had received USD 10.0 mn (Kshs 1.1 bn) from the eco.business Fund for onward lending to sustainable agribusiness, contributing to the fund's mission of conserving biodiversity, promoting the sustainable use of natural resources and mitigating and adapting to climate change, and,
  d) On 25th November 2021, Co-operative Bank announced it had a USD 50 mn (5.7bn) loan facility from the European Investment Bank (EIB). The loan was part of EIB's targeted East Africa COVID-19 Rapid Response facility and was intended to provide support for SMEs, with maximum of 250 employees, in sectors most impacted by the trade, economic, tourism and health challenges triggered by COVID-19 and unlock investment to accelerate private sector recovery from the pandemic.

Income Statement

- Core earnings per share increased by 53.0% to Kshs 2.4 in FY'2021, from Kshs 1.7 in FY'2020, better than our projections of a 29.4% increase to Kshs 2.0. The performance was driven by a 12.3% increase in total operating income to Kshs 60.4 bn in FY'2021, from Kshs 53.8 bn in FY'2020, coupled with a 3.3% decline in the total operating expenses to Kshs 38.1 bn in FY'2021, from Kshs 39.4 bn in FY'2020. The variance in our projections can be attributed to our expectation of a 26.3% increase in loans loss provsions to Kshs 10.3 bn, compared to the actual performance which was a decline of 2.3% to Kshs 7.9 bn from Kshs 8.1 bn,
- Total operating income rose by 12.3% to Kshs 60.4 bn in FY'2021, from Kshs 53.8 bn in FY'2020 mainly due to a 12.9% increase in Net Interest Income (NII) to Kshs 41.0 bn, from Kshs 36.3 bn in FY'2020, coupled with the 11.0% growth in Non-Funded Income (NFI) to Kshs 19.4 bn, from Kshs 17.5 bn in FY'2020,
- Interest income rose by 13.9% to Kshs 55.6 bn in FY'2021, from Kshs 48.8 bn in FY'2020 driven by a 26.4% increase in interest income from government securities to Kshs 18.7 bn, from Kshs 14.8 bn in FY'2020, coupled with a 9.0% rise in interest income from loans and advances to Kshs 36.5 bn, from Kshs 33.5 bn in FY'2020. This growth was however weighed down by a 20.7% decline in interest income from deposits with other financial institutions to Kshs 0.4 bn in FY'2021, from Kshs 0.5 bn in FY'2020. Consequently, the Yield on Interest-Earning Assets increased marginally by 0.1% points to 11.5%, from 11.4% in FY'2020 due to the faster 13.9% growth in trailing interest income, which outpaced the 12.6% growth in the

average interest-earning assets. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,

- Interest expense increased by 17.0% to Kshs 14.6 bn in FY'2021, from Kshs 12.5 bn in FY'2020, largely due to a 21.9% rise in interest expense from customer deposits to Kshs 13.3 bn, from Kshs 10.9 bn in FY'2020. The increase in interest expense was however mitigated by a 19.6% decline in other interest expenses to Kshs 1.1 bn in FY'2021, from Kshs 1.4 bn in FY'2020. As such, cost of funds (COF) increased marginally by 0.1% points to 3.3%, from 3.2% recorded in FY'2020, owing to the faster 17.0% increase in trailing interest expense, compared to the 11.7% rise in the average interest-bearing liabilities; an indication that the Bank was not able to mobilize cheaper deposits. Net Interest Margin (NIM) remained unchanged at 8.5% in FY'2021, similar to what was recorded in FY'2020,
- Non-Funded Income increased by 11.0% to Kshs 19.4 bn in FY'2021, from Kshs 17.5 bn in FY'2020, mainly driven by a 5.7% rise in fees and commissions from loans and advances to Kshs 5.4 bn, from Kshs 5.1 bn in FY'2020. Foreign exchange trading income increased by 0.4% to Kshs 2.85 bn in FY'2021, from Kshs 2.84 bn in FY'2020. Total fees and commissions increased by 18.1% to Kshs 15.2 bn in FY'2021, from Kshs 12.9 bn in FY'2020, attributable to the removal of the waiver of fees on bank-to-mobile transfers. As a result, the revenue mix remained relatively unchanged at 65:35 in FY'2021, similar to what was recorded in FY'2020,
- Total operating expenses reduced by 3.3% to Kshs 38.1 bn in FY'2021, from Kshs 39.4 bn in FY'2020, largely driven by the 2.3% reduction in Loan Loss Provisions (LLP) to Kshs 7.9 bn, from Kshs 8.1 bn in FY'2020 coupled with a 5.7% decrease in other operating expenses to Kshs 16.8 bn, from Kshs 17.9 bn in FY'2020. The reduced provisioning levels are indicative of the reduced credit risk as a result of the improved business environment. Staff costs decreased by 0.7% to Kshs 13.3 bn, from Kshs 13.4 bn in FY'2020,
- The Cost to Income Ratio (CIR) improved to 63.0% in FY'2021, from 73.2% in FY'2020 owing to the 3.3% decline in total operating expenses coupled with the 12.3% increase in total operating income to Kshs 60.4 bn in FY'2021, from Kshs 53.8 bn in FY'2020. Without LLP, the Cost to Income ratio improved as well to 49.9%, from 58.1% in FY'2020, an indication of improving efficiency levels,
- The bank registered a 53.0% increase in profit after tax to Kshs 16.5 bn in FY'2021, from Kshs 10.8 bn in FY'2020, driven by a 12.3% increase in total operating income to Kshs 60.4 bn in FY'2021, from Kshs 53.8 bn in FY'2020, coupled with a 3.3% decline in the total operating expenses to Kshs 38.1 bn in FY'2021, from Kshs 39.4 bn in FY'2020. Profit before tax and exceptional items rose by 58.6% to Kshs 22.6 bn, from Kshs 14.3 bn in FY'2020, with the effective tax rate increasing to 31.9% in FY'2021, from 28.8% seen in FY'2020, and,
- The Board of Directors recommended a final Dividend Per Share (DPS) of Kshs 1.0, translating to a total dividend payout of Kshs 5.9 bn. At the current price of Kshs 13.3, this translates to a dividend yield of 7.5%.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 8.0% to Kshs 579.8 bn in FY'2021, from Kshs 536.9 bn in FY'2020, mainly attributable to the 13.7% growth in government securities to Kshs 184.1 bn, from Kshs 161.9 bn recorded in FY'2020, coupled with an 8.2% growth in net loans and advances to Kshs 310.2 bn in FY'2021, from Kshs 286.6 bn in FY'2020. The faster increase in allocation to government securities highlights the bank's cautious lending strategy considering the relatively lower asset quality, as evidenced by the bank's NPL ratio of 14.6% in FY'2021 compared to the average 12.0% gross NPL ratio of the listed banking sector in Q3'2021,
- Total liabilities grew by 7.7% to Kshs 479.0 bn, from Kshs 444.9 bn in FY'2020, which was largely attributable to a 7.7% rise in customer deposits to Kshs 407.7 bn in FY'2021, from Kshs 378.6 bn in

FY'2020. Deposits per branch increased by 14.8% to Kshs 2.5 bn, from Kshs 2.1 bn in FY'2020, with the number of branches increasing to 178 in FY'2021, from 177 recorded in FY'2020 as the Kenyan subsidiary opened an additional branch to take the total to 174 from 173 in FY'2020,

- The faster 8.2% growth in net loans and advances compared to the 7.7% growth in deposits, led to an increase in the loan to deposit ratio to 76.1%, from 75.7% in FY'2020,
- Gross Non-Performing Loans (NPLs) decreased by 15.9% to Kshs 49.7 bn in FY'2021, from Kshs 59.1 bn in FY'2020. The NPL ratio reduced to 14.6% in FY'2021, from 18.7% in FY'2020, owing to the 15.9% decline in gross non-performing loans coupled with the 7.9% growth in gross loans. The improved asset quality is attributable to the economic recovery witnessed in Kenya in the year 2021 and improved business environment, which saw significant recovery in sectors such as Transport and Communication. Personal consumer, Trade and Transport and Communication, made up 71.4% of Cooperative Bank's loan book as of Q3'2021,
- General Loan Loss Provisions increased by 10.3% to Kshs 24.8 bn, from Kshs 22.5 bn in FY'2020. The NPL coverage ratio consequently improved to 62.6% in FY'2021, from 50.3% in FY'2020, due to a 4.7% growth in General Loan Loss Provisions coupled with the 15.9% decline in Gross Non-Performing Loans (NPLs),
- Shareholders' funds increased by 10.5% to Kshs 100.2 bn in FY'2021, from Kshs 90.7 bn in FY'2020, mainly driven by a 12.9% increase in the retained earnings to Kshs 84.2 bn, from Kshs 74.6 bn in FY'2020,
- Co-operative Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.6%, 5.1% points above the statutory requirement of 10.5%. The total capital to risk-weighted assets ratio came in at 17.2%, exceeding the statutory requirement of 14.5% by 2.7% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 12.8%, while total capital to risk-weighted assets came in at 14.3%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.0%, and a Return on Average Equity (ROaE) of 17.3%.

Key Take-Outs:

1. Total operating expenses reduced by 3.3% to Kshs 38.1 bn in FY'2021, from Kshs 39.4 bn in FY'2020, largely driven by the 2.3% reduction in Loan Loss Provisions (LLP) to Kshs 7.9 bn, from Kshs 8.1 bn in FY'2020 coupled with a 5.7% decrease in other operating expenses to Kshs 16.8 bn, from Kshs 17.9 bn in FY'2020. The reduced provisioning levels are indicative of the reduced credit risk as a result of the improved business environment, and,
2. The bank's asset quality improved, with the NPL ratio reducing to 14.6% in FY'2021, from 18.7% in FY'2020, owing to the 15.9% decline in gross non-performing loans coupled with the 7.9% growth in gross loans. The improved asset quality is attributable to the economic recovery witnessed in Kenya in the year 2021 and improved business environment, which saw significant recovery in sectors such as Transport and Communication. Personal consumer, Trade and Transport and Communication, made up 71.4% of Cooperative Bank's loan book as of Q3'2021. It is important to note that Co-op's NPL Ratio has improved in the last four quarters where the ratio was at 18.7% in Q4'2020, 15.8% in Q1'2021, 15.3% in H1'2021 and 14.6% in Q3'2021.

Going forward, we expect the bank's growth to be driven by:

I. Focus on diversification: The bank's continued focus on channel diversification will likely continue to help the bank in generating profitability, as they continue to record increased usage and traffic. The focus on branch transformation and innovation centered on alternative channels will continue to drive NFI growth as well as transform braches to handle advisory, wealth management and advisory services.

Valuation Summary

- We are of the view that Co-operative Bank is **fairly valued** with a target price of Kshs 13.3, from the current price of Kshs 13.3 as of 18th March 2022. However, the total return is 7.5% due to the banks' 7.5% dividend yield, and,
- Co-operative Bank is currently trading at a P/TBV of 0.8x and a P/E of 4.7x vs an industry average of 1.1x and 5.6x, respectively.