

Below is a summary of Co-operative Bank of Kenya Ltd H1'2022 performance:

Balance Sheet Items (Kshs bn)	H1'2021	H1'2022	y/y change
Government Securities	182.0	183.2	0.7%
Net Loans and Advances	301.2	330.1	9.6%
Total Assets	573.0	603.9	5.4%
Customer Deposits	407.7	423.0	3.8%
Deposits per Branch	2.3	2.4	3.2%
Total Liabilities	480.4	506.9	5.5%
Shareholders' Funds	92.6	96.7	4.4%

Balance Sheet Ratios	H1'2021	H1'2022	% points y/y change
Loan to Deposit Ratio	73.9%	78.0%	4.1%
Return on average equity	12.7%	21.8%	9.1%
Return on average assets	2.0%	3.5%	1.5%

Income Statement (Kshs bn)	H1'2021	H1'2022	y/y change
Net Interest Income	18.8	21.1	11.8%
Non-Interest Income	10.3	13.3	28.8%
Total Operating income	29.2	34.4	17.8%
Loan Loss provision	(4.2)	(3.3)	(19.6%)
Total Operating expenses	(18.7)	(19.2)	2.5%
Profit before tax	10.5	15.3	45.2%
Profit after tax	7.4	11.5	55.7%
Earnings per share (Kshs)	1.1	1.7	55.7%

Income Statement Ratios	H1'2021	H1'2022	% points y/y change
Yield from interest-earning assets	11.7%	11.4%	(0.3%)
Cost of funding	3.1%	3.2%	0.1%
Net Interest Spread	8.5%	8.2%	(0.3%)
Net Interest Income as % of Total Income	64.6%	61.3%	(3.3%)
Non-Funded Income as a % of Total Income	35.4%	38.7%	3.3%
Cost to Income	64.1%	55.8%	(8.3%)
Cost to Income Ratio without provisions	49.9%	46.0%	(3.9%)
Cost to Assets	2.5%	2.6%	0.1%
Net Interest Margin	8.6%	8.4%	(0.2%)

Capital Adequacy Ratios	H1'2021	H1'2022	% points change
Core Capital/Total deposit Liabilities	18.2%	19.7%	1.5%
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess	10.2%	11.7%	1.5%
Core Capital/Total Risk Weighted Assets	15.3%	15.5%	0.2%
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess	4.8%	5.0%	0.2%
Total Capital/Total Risk Weighted Assets	17.0%	16.6%	(0.4%)
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess	2.5%	2.1%	(0.4%)
Liquidity Ratio	55.7%	50.8%	(4.9%)
Minimum Statutory ratio	20.0%	20.0%	0.0%

Excess	35.7%	30.8%	(4.9%)
Adjusted Core Capital/Total Deposit Liabilities	15.6%	15.6%	0.0%
Adjusted Core Capital/Total Risk Weighted Assets	13.1%	12.2%	(0.9%)
Adjusted Total Capital/Total Risk Weighted Assets	14.8%	13.4%	(1.4%)

Income Statement

- Core earnings per share increased by 55.7% to Kshs 1.7 in H1'2022, from Kshs 1.1 in H1'2021, higher than our projections of 12.9% increase to Kshs 1.2 bn. The performance was driven by a 17.8% increase in total operating income to Kshs 34.4 bn in H1'2022, from Kshs 29.2 bn in H1'2021, which outpaced the 2.5% increase in the total operating expenses to Kshs 19.2 bn in H1'2022, from Kshs 18.7 bn in H1'2021,
- Total operating income rose by 17.8% to Kshs 34.4 bn in H1'2022, from Kshs 29.2 bn in H1'2021 mainly driven by an 11.8% increase in Net Interest Income (NII) to Kshs 21.1 bn, from Kshs 18.8 bn in H1'2021 coupled with a 28.8% growth in Non-Funded Income (NFI) to Kshs 13.3 bn, from Kshs 10.3 bn in H1'2021,
- Interest income rose by 10.0% to Kshs 28.6 bn in H1'2022, from Kshs 26.0 bn in H1'2021 driven by a 9.4% increase in interest income from loans and advances to Kshs 18.5 bn, from Kshs 16.9 bn in H1'2021, coupled with an 11.9% increase in interest income from government securities to Kshs 9.9 bn, from Kshs 8.8 bn in H1'2021. Notably, the Yield on Interest-Earning Assets declined by 0.3% points to 11.4%, from 11.7% in H1'2021 due to the faster 12.8% growth in the average interest-earning assets, which outpaced the 10.0% growth in trailing interest income. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense increased by 5.5% to Kshs 7.5 bn in H1'2022, from Kshs 7.1 bn in H1'2021, largely due to a 5.9% growth in interest expense on customer deposits to Kshs 6.8 bn, from Kshs 6.4 bn in H1'2021. Consequently, Cost of funds (COF) increased by 0.1% points to 3.2%, from 3.1% as recorded in H1'2021, owing to the 15.0% increase in trailing interest expense, which outpaced the 6.9% rise in the average interest-bearing liabilities. On the other hand, Net Interest Margin (NIM) declined to 8.4% in H1'2022, from 8.6% in H1'2021, attributable to the 12.8% growth in average interest-earning assets (NII), which outpaced the 10.0% growth of trailing Net Interest Income,
- Non-Funded Income increased by 28.8% to Kshs 13.3 bn in H1'2022, from Kshs 10.3 bn in H1'2021, mainly driven by a 103.7% rise in fees and commissions from loans and advances to Kshs 5.5 bn, from Kshs 2.7 bn in H1'2021, attributable to a 9.6% increase in Net loans and advance to Kshs 330.1 bn, from Kshs 301.2 bn in H1'2021. Foreign exchange trading income also increased by 48.1% to Kshs 2.0 bn in H1'2022, from Kshs 1.3 bn in H1'2021. Co-operative Bank's total fees and commissions increased by 36.8% to Kshs 10.9 bn in H1'2022, from Kshs 8.0 bn in H1'2021. As a result, the revenue mix shifted to 61:39 funded to non-funded income, from 65:35 funded to non-funded income in H1'2022, owing to the 28.8% increase in NFI which outpaced the 11.8% growth in NII,
- Total operating expenses increased by 2.5% to Kshs 19.2 bn in H1'2022, from Kshs 18.7 bn in H1'2021, largely driven by an 8.6% increase in staff costs to Kshs 7.1 bn, from Kshs 6.5 bn in H1'2021 coupled with an 8.9% increase in other operating expenses to Kshs 8.7 bn, from Kshs 8.0 bn in H1'2021. the increase in total operating expenses was mitigated by a 19.6% decline in Loan Loss Provisions (LLP) to Kshs 3.3 bn, from Kshs 4.2 bn in H1'2021. The reduced provisioning levels are indicative of the reduced credit risk as a result of the improved business environment,
- The Cost to Income Ratio (CIR) improved to 55.8% in H1'2022, from 64.1% in H1'2021 owing to the 17.8% increase in the total operating income which outpaced the 2.5% increase in the total operating expenses. Without LLP, the Cost to Income ratio improved as well to 46.0%, from 49.9% in H1'2021, an indication of improving efficiency levels, and,
- Profit before tax and exceptional items rose by 45.2% to Kshs 15.3 bn, from Kshs 10.5 bn in H1'2021, with the effective tax rate declining to 29.0% in H1'2022, from 30.0% seen in H1'2021. Similarly, the bank recorded a 55.7% increase in profit after tax to Kshs 11.5 bn in H1'2022, from Kshs 7.4 bn in H1'2021.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 5.4% to Kshs 603.9 bn in H1'2022, from Kshs 573.0 bn in H1'2021, mainly attributable the 9.6% growth in net loans and advances to Kshs 330.1 bn in H1'2022, from Kshs 301.2 bn in H1'2021, coupled with a 0.7% growth in government securities to Kshs 183.2 bn, from Kshs 182.0 bn recorded in H1'2021,
- Total liabilities grew by 5.5% to Kshs 506.9 bn, from Kshs 480.4 bn in H1'2021, largely attributable to a 3.8% rise in customer deposits to Kshs 423.0 bn in H1'2022, from Kshs 407.7 bn in H1'2021. Deposits per branch increased by 3.2% to Kshs 2.4 bn, from Kshs 2.3 bn in H1'2021, with the number of branches increasing to 180 in H1'2022, from 177 recorded in H1'2021,
- The faster 9.6% growth in net loans and advances compared to the 3.8% growth in deposits, led to an increase in the loan to deposit ratio to 78.0%, from 73.9% in H1'2021,
- Gross Non-Performing Loans (NPLs) increased by 0.7% to Kshs 51.2 bn in H1'2022, from Kshs 50.8 bn in H1'2021. However, the NPL ratio reduced to 14.1% in H1'2022, from 15.2% in H1'2021, owing to the 9.1% growth in gross loans to Kshs 363.8 bn, from Kshs 333.5 bn in H1'2021, which outpaced a 0.7% increase in gross non-performing loans. The improved asset quality is attributable to the continued economic recovery, improved business environment as well as the Group's proactive credit management strategies,
- Provisions increased by 8.8% to Kshs 27.7 bn, from Kshs 25.5 bn in H1'2021. The NPL coverage ratio consequently improved to 65.8% in H1'2022, from 63.5% in H1'2021, due to the faster growth in provisions which outpaced the 0.7% increase in Gross Non-Performing Loans (NPLs),
- Shareholders' funds increased by 4.4% to Kshs 96.7 bn in H1'2022, from Kshs 92.6 bn in H1'2021, mainly driven by a 16.9% increase in the retained earnings to Kshs 95.5 bn, from Kshs 81.7 bn in H1'2021,
- Co-operative Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.5%, 5.0% points above the statutory requirement of 10.5%. The total capital to risk-weighted assets ratio came in at 16.6%, exceeding the statutory requirement of 14.5% by 2.1% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 12.2%, while total capital to risk-weighted assets came in at 13.4%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.5%, and a Return on Average Equity (ROaE) of 21.8%.

Key Take-Outs:

1. **Improvement in Asset Quality** – the group's asset quality improved, with the NPL ratio reducing to 14.1% in H1'2022, from 15.2% in H1'2021, owing to the 9.1% growth in gross loans to Kshs 363.8 bn, from Kshs 333.5 bn in H1'2021, which outpaced the 0.7% increase in gross non-performing loans. The improved asset quality was attributable to the continued economic recovery which has seen more business pick up and more people going back to their jobs given that the group's loan book constituted 50.1% personal consumer loans as of Q1'2022. The group has also embarked on proactive credit management strategies that have seen increased loan repayments.

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 branches to handle advisory, wealth management and advisory services.

Valuation Summary

- We are of the view that Co-operative Bank is an “BUY” with a target price of Kshs 15.0, representing an upside of 24.2%, from the current price of Kshs 12.1 as of 27th May 2022, inclusive of a dividend yield of 9.1%,
- Co-operative Bank is currently trading at a P/TBV of 0.7x and a P/E of 4.3x vs an industry average of 0.8x and 4.5x, respectively.