Co-operative Bank of Kenya Ltd – Q1'2022

27th May, 2022

Below is a summary of Co-operative Bank of Kenya Ltd Q1'2022 performance:

Balance Sheet Items (Kshs bn)	Q1'2021	Q1'2022	y/y change
Government Securities	166.2	183.4	10.4%
Net Loans and Advances	298.2	324.5	8.8%
Total Assets	**552.9**	**597.0**	**8.0%**
Customer Deposits	393.8	410.8	4.3%
Total Liabilities	**458.3**	**493.9**	**7.8%**
Shareholders' Funds	**93.7**	**102.7**	**9.6%**

Balance Sheet Ratios	Q1'2021	Q1'2022	% points y/y change
Loan to Deposit Ratio	75.7%	79.0%	3.3%
Return on average equity	12.3%	19.3%	7.0%
Return on average assets	2.1%	3.3%	1.2%

Income Statement (Kshs bn)	Q1'2021	Q1'2022	y/y change
Net Interest Income	9.8	10.4	5.5%
Non-Interest Income	4.5	6.4	41.7%
Total Operating income	**14.4**	**16.8**	**16.9%**
Loan Loss provision	(2.3)	(1.5)	(32.3%)
Total Operating expenses	(9.3)	(9.0)	(2.5%)
Profit before tax	5.0	7.8	56.3%
Profit after tax	**3.5**	**5.8**	**68.9%**
Earnings per share (Kshs)	**0.5**	**0.8**	**68.9%**

Income Statement Ratios	Q1'2021	Q1'2022	% points y/y change
Yield from interest-earning assets	11.6%	11.2%	(0.4%)
Cost of funding	3.2%	3.2%	-
Net Interest Spread	8.3%	7.9%	(0.4%)
Net Interest Income as % of operating income	68.5%	61.8%	(6.7%)
Non-Funded Income as a % of operating income	31.5%	38.2%	6.7%
Cost to Income	64.5%	53.8%	(10.7%)
Cost to Income Ratio without provisions	48.6%	44.6%	(4.0%)
Cost to Assets	1.3%	1.3%	-
Net Interest Margin	8.6%	8.3%	(0.3%)

Capital Adequacy Ratios	Q1'2021	Q1'2022
Core Capital/Total deposit Liabilities	18.4%	19.8%
Minimum Statutory ratio	8.0%	8.0%
Excess	**10.4%**	**11.8%**
Core Capital/Total Risk Weighted Assets	15.2%	15.3%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.7%**	**4.8%**
Total Capital/Total Risk Weighted Assets	16.9%	16.6%
Minimum Statutory ratio	14.5%	14.5%
Excess	**2.4%**	**2.1%**
Liquidity Ratio	54.8%	54.1%
Minimum Statutory ratio	20.0%	20.0%

Excess	**34.8%**	**34.1%**
Adjusted Core Capital/Total Risk Weighted Assets	13.3%	12.3%
Adjusted Total Capital/Total Risk Weighted Assets	15.1%	13.6%

Income Statement

- Core earnings per share increased by 68.9% to Kshs 0.8 in Q1’2022, from Kshs 0.5 in Q1’2021, in line with our projections. The performance was driven by a 16.9% increase in total operating income to Kshs 16.8 bn in Q1’2022, from Kshs 14.4 bn in Q1’2021, coupled with a 2.5% decline in the total operating expenses to Kshs 9.0 bn in Q1’2022, from Kshs 9.3 bn in Q1’2021,
- Total operating income rose by 16.9% to Kshs 16.8 bn in Q1’2022, from Kshs 14.4 bn in Q1’2021 mainly due to a 41.7% growth in Non-Funded Income (NFI) to Kshs 6.4 bn, from Kshs 4.5 bn in Q1’2021, coupled with a 5.5% increase in Net Interest Income (NII) to Kshs 10.4 bn, from Kshs 9.8 bn in Q1’2021. The strong growth in NFI is attributable to increased revenue diversification strategies from the Group which has seen share of income from subsidiaries such as the asset management continue to increase. In FY’2021, the asset management subsidiary, Co-op Trust Investment Services Ltd recorded a 101.0% increase in its profit after tax to Kshs 140.4 mn from Kshs 70.0 mn in FY’2020,
- Interest income rose by 4.1% to Kshs 14.0 bn in Q1’2022, from Kshs 13.4 bn in Q1’2021 driven by a 19.5% increase in interest income from government securities to Kshs 4.9 bn, from Kshs 4.1 bn in Q1’2021, coupled with a 99.2% rise in interest income from placements with other banking institutions to Kshs 82.6 mn from, Kshs 41.5 mn. This growth was however weighed down by a 2.9% decline in interest income from loans and advances to Kshs 9.0 bn, from Kshs 9.2 bn in Q1’2021. Notably, the Yield on Interest-Earning Assets declined by 0.4% points to 11.2%, from 11.6% in Q1’2021 due to the faster 12.3% growth in the average interest-earning assets, which outpaced the 8.6% 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 0.3% to Kshs 3.63 bn in Q1’2022, from Kshs 3.62 bn in Q1’2021, largely due to a 3.1% rise in interest expense from customer deposits to Kshs 3.3 bn, from Kshs 3.2 bn in Q1’2021. The increase in interest expense was however mitigated by a 6.7% decline in other interest expenses to Kshs 0.3 bn in Q1’2022, from Kshs 0.4 bn in Q1’2021. As such, cost of funds (COF) remained relatively unchanged at 3.2%, as recorded in Q1’2021, owing to the 11.7% increase in trailing interest expense, which matched the 11.3% rise in the average interest-bearing liabilities. Net Interest Margin (NIM) declined to 8.3% in Q1’2022, from 8.6% in Q1’2021, attributable to the 12.3% growth in average interest-earning assets (NII), which outpaced the 7.6% growth of trailing Net Interest Income,
- Non-Funded Income increased by 41.7% to Kshs 6.4 bn in Q1’2022, from Kshs 4.5 bn in Q1’2021, mainly driven by a 94.4% rise in fees and commissions from loans and advances to Kshs 2.6 bn, from Kshs 1.3 bn in Q1’2021, coupled with a 17.4% increase in other fees and commissions income to Kshs 2.8 bn, from Kshs 2.4 bn in Q1’2021. Additionally, Foreign exchange trading income increased by 7.5% to Kshs 0.8 bn in Q1’2022, from Kshs 0.7 bn in Q1’2021. Total fees and commissions increased by 45.2% to Kshs 5.4 bn in Q1’2022, from Kshs 3.7 bn in Q1’2021, attributable to the removal of the waiver of fees on bank-to-mobile transfers. As a result, the revenue mix shifted to 62:38 funded to non-funded income, from 68:32 funded to non-funded income in Q1’2022, owing to the 41.7% increase in NFI which outpaced the 5.5% growth in NII,
- Total operating expenses declined by 2.5% to Kshs 9.3 bn in Q1’2022, from Kshs 9.0 bn in Q1’2021, largely driven by the 32.3% reduction in Loan Loss Provisions (LLP) to Kshs 1.5 bn, from Kshs 2.3 bn in Q1’2021. The reduced provisioning levels are indicative of the reduced credit risk as a result of the improved business environment. On the other hand, staff coats increased by 9.4% to Kshs 3.5 bn, from Kshs 3.2 bn in Q1’2021, while in other operating expenses increased by 5.5% to Kshs 4.0 bn, from Kshs 3.8 bn in Q1’2021,

- The Cost to Income Ratio (CIR) improved to 53.8% in Q1’2022, from 64.5% in Q1’2021 owing to the 2.5% decline in total operating expenses coupled with the 16.9% increase in total operating income to Kshs 16.8 bn in Q1’2022, from Kshs 14.4 bn in Q1’2021. Without LLP, the Cost to Income ratio improved as well to 44.6%, from 48.6% in Q1’2021, an indication of improving efficiency levels, and,
- The bank registered a 68.9% increase in profit after tax to Kshs 5.8 bn in Q1’2022, from Kshs 3.6 bn in Q1’2021, driven by a 16.9% increase in total operating income to Kshs 16.8 bn in Q1’2022, from Kshs 14.4 bn in Q1’2021, coupled with a 2.5% decline in the total operating expenses to Kshs 9.0 bn in Q1’2022, from Kshs 9.3 bn in Q1’2021. Profit before tax and exceptional items rose by 56.3% to Kshs 7.8 bn, from Kshs 3.5 bn in Q1’2021, with the effective tax rate declining to 29.0% in Q1’2022, from 30.7% seen in Q1’2021.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 8.0% to Kshs 597.0 bn in Q1’2022, from Kshs 552.9 bn in Q1’2021, mainly attributable to the 10.4% growth in government securities to Kshs 183.4 bn, from Kshs 166.2 bn recorded in Q1’2021, coupled with an 8.8% growth in net loans and advances to Kshs 324.5 bn in Q1’2022, from Kshs 298.2 bn in Q1’2021. The higher increase in allocation to government securities highlights the bank’s cautious lending strategy,
- Total liabilities grew by 7.8% to Kshs 493.9 bn, from Kshs 458.3 bn in Q1’2021, which was largely attributable to a 4.3% rise in customer deposits to Kshs 410.8 bn in Q1’2022, from Kshs 393.8 bn in Q1’2021. Deposits per branch increased by 3.7% to Kshs 2.3 bn, from Kshs 2.2 bn in Q1’2021, with the number of branches increasing to 178 in Q1’2022, from 177 recorded in Q1’2021,
- The faster 8.8% growth in net loans and advances compared to the 4.3% growth in deposits, led to an increase in the loan to deposit ratio to 79.0%, from 75.7% in Q1’2021,
- Gross Non-Performing Loans (NPLs) decreased by 4.9% to Kshs 49.5 bn in Q1’2022, from Kshs 52.0 bn in Q1’2021. The NPL ratio reduced to 13.9% in Q1’2022, from 15.8% in Q1’2021, owing to the 4.9% decline in gross non-performing loans coupled with the 8.6% growth in gross loans. The improved asset quality is attributable to the economic recovery witnessed in Kenya in Q1’2022 and improved business environment, which saw significant recovery in sectors such as Transport and Communication. Personal consumer, Trade and Transport and Communication, made up 72.2% of Cooperative Bank’s loan book as of FY’2021,
- General Loan Loss Provisions increased by 10.4% to Kshs 26.1 bn, from Kshs 23.6 bn in Q1’2021. The NPL coverage ratio consequently improved to 65.3% in Q1’2022, from 58.4% in Q1’2021, due to the 10.4% growth in General Loan Loss Provisions coupled with the 4.9% decline in Gross Non-Performing Loans (NPLs),
- Shareholders’ funds increased by 9.6% to Kshs 102.7 bn in Q1’2022, from Kshs 93.7 bn in Q1’2021, mainly driven by a 15.6% increase in the retained earnings to Kshs 90.1 bn, from Kshs 77.9 bn in Q1’2021,
- Co-operative Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.3%, 4.8% 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 12.3%, while total capital to risk-weighted assets came in at 13.6%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.3%, and a Return on Average Equity (ROaE) of 19.3%.

Key Take-Outs:

1. Total operating expenses declined by 2.5% to Kshs 9.3 bn in Q1’2022, from Kshs 9.0 bn in Q1’2021, largely driven by the 32.3% reduction in Loan Loss Provisions (LLP) to Kshs 1.5 bn, from Kshs 2.3 bn in Q1’2021.

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 13.9% in Q1'2022, from 15.8% in Q1'2021, owing to the 4.9% decline in gross non-performing loans coupled with the 8.6% growth in gross loans. The improved asset quality is attributable to the economic recovery witnessed in Kenya in Q1'2021 and improved business environment, which saw significant recovery in sectors such as Transport and Communication. Personal consumer, Trade and Transport and Communication, made up 72.2% of Cooperative Bank's loan book as of FY'2021. It is important to note that Co-op's NPL Ratio has improved in the last four quarters where the ratio was at 15.8% in Q1'2021, 15.3% in H1'2021 and 14.6% in both Q3'2021 and FY'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 an "BUY" with a target price of Kshs 14.2, representing an upside of 27.4%, from the current price of Kshs 12.0 as of 27th May 2022, inclusive of a dividend yield of 8.4%,
- Co-operative Bank is currently trading at a P/TBV of 0.7x and a P/E of 4.2x vs an industry average of 0.8x and 4.6x, respectively.