

Below is a summary of Co-operative Bank of Kenya Ltd Q3'2022 performance:

Balance Sheet Items (Kshs bn)	Q3'2021	Q3'2022	y/y change
Government Securities	193.3	182.4	(5.7%)
Net Loans and Advances	306.3	335.2	9.4%
<b>Total Assets</b>	<b>592.9</b>	<b>622.1</b>	<b>4.9%</b>
Customer Deposits	420.4	432.0	2.8%
Deposits per Branch	2.38	2.39	0.5%
<b>Total Liabilities</b>	<b>497.5</b>	<b>520.9</b>	<b>4.7%</b>
<b>Shareholders' Funds</b>	<b>95.0</b>	<b>100.9</b>	<b>6.2%</b>

Balance Sheet Ratios	Q3'2021	Q3'2022	y/y change
Loan to Deposit Ratio	72.9%	77.6%	4.7%
Return on average equity	14.2%	22.5%	8.3%
Return on average assets	2.3%	3.6%	1.3%

Income Statement (Kshs bn)	Q3'2021	Q3'2022	y/y change
Net Interest Income	28.7	32.0	11.7%
Non-Interest Income	15.7	20.2	28.3%
<b>Total Operating income</b>	<b>44.4</b>	<b>52.2</b>	<b>17.6%</b>
Loan Loss provision	(6.0)	(5.7)	(5.3%)
Total Operating expenses	(28.0)	(29.6)	6.0%
Profit before tax	16.5	22.7	37.9%
<b>Profit after tax</b>	<b>11.6</b>	<b>17.1</b>	<b>47.0%</b>
Earnings per share (Kshs)	1.7	2.5	47.0%

Income Statement Ratios	Q3'2021	Q3'2022	Y/Y Change
Yield from interest-earning assets	11.5%	11.4%	(0.1%)
Cost of funding	3.3%	3.2%	(0.1%)
Net Interest Spread	8.2%	8.2%	-
Net Interest Income as % of Total Income	64.6%	61.4%	(3.2%)
Non-Funded Income as a % of Total Income	35.4%	38.6%	3.2%
Cost to Income	63.0%	56.8%	(6.2%)
Cost to Income Ratio without provisions	49.4%	45.8%	(3.6%)
Cost to Assets	3.7%	3.8%	0.1%
Net Interest Margin	8.5%	8.5%	-

Capital Adequacy Ratios	Q3'2021	Q3'2022	% points change
Core Capital/Total deposit Liabilities	18.0%	19.7%	1.7%
Minimum Statutory ratio	8.0%	8.0%	
<b>Excess</b>	<b>10.0%</b>	<b>11.7%</b>	<b>1.7%</b>
Core Capital/Total Risk Weighted Assets	15.0%	15.7%	0.7%
Minimum Statutory ratio	10.5%	10.5%	
<b>Excess</b>	<b>4.5%</b>	<b>5.2%</b>	<b>0.7%</b>
Total Capital/Total Risk Weighted Assets	16.5%	16.8%	0.3%
Minimum Statutory ratio	14.5%	14.5%	
<b>Excess</b>	<b>2.0%</b>	<b>2.3%</b>	<b>0.3%</b>
Liquidity Ratio	56.5%	52.1%	(4.4%)
Minimum Statutory ratio	20.0%	20.0%	

Excess	36.5%	32.1%	(4.4%)
Adjusted Core Capital/Total Deposit Liabilities	15.0%	15.2%	0.2%
Adjusted Core Capital/Total Risk Weighted Assets	12.5%	12.1%	(0.4%)
Adjusted Total Capital/Total Risk Weighted Assets	14.0%	13.2%	(0.8%)

**Income Statement**

- Core earnings per share increased by 47.0% to Kshs 2.5 in Q3'2022, from Kshs 1.7 in Q3'2021, higher than our projections of 24.8% increase to Kshs 2.1. The performance was driven by a 17.6% increase in total operating income to Kshs 52.2 bn in Q3'2022, from Kshs 44.4 bn in Q3'2021, which outpaced the 6.0% increase in the total operating expenses to Kshs 29.6 bn in Q3'2022, from Kshs 28.0 bn in Q3'2021,
- Total operating income rose by 17.6% to Kshs 52.2 bn in Q3'2022, from Kshs 44.4 bn in Q3'2021 mainly driven by an 11.7% increase in Net Interest Income (NII) to Kshs 32.0 bn, from Kshs 28.7 bn in Q3'2021 coupled with a 28.3% growth in Non-Funded Income (NFI) to Kshs 20.2 bn, from Kshs 15.7 bn in Q3'2021,
- Interest income rose by 10.5% to Kshs 43.7 bn in Q3'2022, from Kshs 39.6 bn in Q3'2021 driven by a 9.6% increase in interest income from loans and advances to Kshs 27.9 bn, from Kshs 25.4 bn in Q3'2021, coupled with a 12.5% increase in interest income from government securities to Kshs 15.5 bn, from Kshs 13.8 bn in Q3'2021. The Yield on Interest-Earning Assets declined slightly by 0.1% points to 11.4%, from 11.5% in Q3'2021 due to the faster 7.8% growth in the average interest-earning assets, which outpaced the 7.0% 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 7.2% to Kshs 11.7 bn in Q3'2022, from Kshs 10.9 bn in Q3'2021, largely due to a 6.6% growth in interest expense on customer deposits to Kshs 10.5 bn, from Kshs 9.8 bn in Q3'2021. However, Cost of funds (COF) declined by 0.1% points to 3.2%, from 3.3% as recorded in Q3'2021, owing to the 8.7% increase in average interest bearing liabilities, which outpaced the 6.3% rise in the trailing interest expense. On the other hand, Net Interest Margin (NIM) remained relatively unchanged at 8.2%, attributable to the 7.8% growth in average interest-earning assets (NII), evened out by a 7.3% growth of trailing Net Interest Income,
- Non-Funded Income increased by 28.3% to Kshs 20.2 bn in Q3'2022, from Kshs 15.7 bn in Q3'2021, mainly driven by a 52.0% rise in fees and commissions from loans and advances to Kshs 8.4 bn, from Kshs 5.5 bn in Q3'2021, following a 9.4% increase in Net loans and advance to Kshs 335.2 mn, from Kshs 306.3 mn in Q3'2021. Additionally, foreign exchange trading income increased by 71.6% to Kshs 3.3 bn in Q3'2022, from Kshs 1.9 bn in Q3'2021. Co-operative Bank's total fees and commissions increased by 31.7% to Kshs 16.3 bn in Q3'2022, from Kshs 12.4 bn in Q3'2021. As a result, the revenue mix shifted to 61:39 funded to non-funded income, from 65:35 funded to non-funded income in Q3'2022, owing to the 28.3% increase in NFI which outpaced the 11.7% growth in NII,
- Total operating expenses increased by 6.0% to Kshs 29.6 bn in Q3'2022, from Kshs 28.0 bn in Q3'2021, largely driven by an 8.1% increase in staff costs to Kshs 10.8 bn, from Kshs 10.0 bn in Q3'2021 coupled with a 9.9% increase in other operating expenses to Kshs 13.1 bn, from Kshs 11.9 bn in Q3'2021. The increase in total operating expenses was mitigated by a 5.3% decline in Loan Loss Provisions (LLP) to Kshs 5.7 bn, from Kshs 6.0 bn in Q3'2021. The reduced provisioning levels are indicative of the reduced credit risk as a result of the improving business environment,
- The Cost to Income Ratio (CIR) improved to 56.8% in Q3'2022, from 63.0% in Q3'2021 owing to the 17.6% increase in the total operating income which outpaced the 6.0% increase in the total operating expenses. Without LLP, the Cost to Income ratio improved as well to 45.8%, from 49.4% in Q3'2021, an indication of improving efficiency levels, and,
- Profit before tax and exceptional items rose by 37.9% to Kshs 22.7 bn, from Kshs 16.5 bn in Q3'2021, with the effective tax rate declining to 28.8% in Q3'2022, from 29.5% seen in Q3'2021. Similarly, the

bank recorded a 47.0% increase in profit after tax to Kshs 17.1 bn in Q3'2022, from Kshs 11.6 bn in Q3'2021.

### Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 4.9% to Kshs 622.1 bn in Q3'2022, from Kshs 592.9 bn in Q3'2021, mainly attributable the 9.4% growth in net loans and advances to Kshs 335.2 bn in Q3'2022, from Kshs 306.3 bn in Q3'2021. However, government securities declined by 5.7% to Kshs 182.4 bn, from Kshs 193.3 bn recorded in Q3'2021, indicating a shift to increased lending as compared to allocation to government following the improving business conditions post-election,
- Total liabilities grew by 4.7% to Kshs 520.9 bn, from Kshs 497.5 bn in Q3'2021, largely attributable to a 2.8% rise in customer deposits to Kshs 432.0 bn in Q3'2022, from Kshs 420.4 bn in Q3'2021 and a significant 171.4% growth in placements to Kshs 10.5 bn from Kshs 3.9 bn recorded in Q3'2021. Deposits per branch increased marginally by 0.5% to Kshs 2.39 bn, from Kshs 2.38 bn in Q3'2021, with the number of branches increasing to 181 in Q3'2022, from 177 recorded in Q3'2021,
- The faster 9.4% growth in net loans and advances compared to the 2.8% growth in deposits, led to an increase in the loan to deposit ratio to 77.6%, from 72.9% in Q3'2021,
- Gross Non-Performing Loans (NPLs) increased by 4.7% to Kshs 51.8 bn in Q3'2022, from Kshs 49.5 bn in Q3'2021. However, the NPL ratio reduced to 14.0% in Q3'2022, from 14.6% in Q3'2021, owing to the 9.5% growth in gross loans to Kshs 371.1 bn, from Kshs 338.7 bn in Q3'2021, which outpaced the 4.7% 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 16.4% to Kshs 29.8 bn, from Kshs 25.6 bn in Q3'2021. The NPL coverage ratio consequently improved to 69.3% in Q3'2022, from 65.5% in Q3'2021, due to the faster 16.4% growth in provisions which outpaced the 4.7% increase in Gross Non-Performing Loans (NPLs),
- Shareholders' funds increased by 6.2% to Kshs 100.9 bn in Q3'2022, from Kshs 95.0 bn in Q3'2021, mainly driven by a 18.5% increase in the retained earnings to Kshs 101.0 bn, from Kshs 85.2 bn in Q3'2021,
- Co-operative Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.7%, 5.2% points above the statutory requirement of 10.5%. The total capital to risk-weighted assets ratio came in at 16.8%, exceeding the statutory requirement of 14.5% by 2.3% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 12.1%, while total capital to risk-weighted assets came in at 13.2%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.6%, and a Return on Average Equity (ROaE) of 22.5%.

### **Key Take-Outs:**

1. **Improvement in Asset Quality** – The group's asset quality improved, with the NPL ratio reducing to 14.0% in Q3'2022, from 14.6% in Q3'2021, owing to the 9.5% growth in gross loans to Kshs 371.1 bn, from Kshs 338.7 bn in Q3'2021, which outpaced the 4.7% 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 50.5% personal consumer loans as of Q2'2022. The group has also embarked on proactive credit management strategies that have seen increased loan repayments, and,
2. **Improved Efficiency** - The group enhanced their efficiency levels evidenced by an improvement in Cost to Income Ratio (CIR) improving to 56.8% in Q3'2022, from 63.0% in Q3'2021 owing to the 17.6% increase in the total operating income which outpaced the 6.0% increase in the total operating expenses. Without LLP, the Cost to Income ratio improved as well to 45.8%, from 49.4% in Q3'2021.

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

- I. **Diversification:** The bank's continued concentration on channel diversification will likely see it continue generating more profit, as they will continue to record increased usage and traffic. As of Q2'2022, 94.0% of the transactions were done on the alternative channels such as mobile and internet increasing Non-Funded Income by 28.3% to Kshs 20.2 bn in Q3'2022, from Kshs 15.7 bn in Q3'2021. The focus on branch transformation and innovation centered on alternative channels will continue to drive NFI growth and also 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 15.1, representing an upside of 25.5%, from the current price of Kshs 12.0 as of 18<sup>th</sup> November 2022,
- Co-operative Bank is currently trading at a P/TBV of 0.7x and a P/E of 3.4x vs an industry average of 0.8x and 4.6x, respectively.