Cooperative Bank of Kenya– FY'2023

21st March, 2024

Below is a summary of Cooperative Bank of Kenya's FY'2023 performance:

Balance Sheet	FY'2022 (Kshs bn)	FY'2023 (Kshs bn)	y/y change
Government Securities	173.3	189.0	9.1%
Net Loans and Advances	339.4	374.2	10.3%
Total Assets	607.2	671.1	10.5%
Customer Deposits	423.8	451.6	6.6%
Total Liabilities	499.3	557.5	11.7%
Shareholders Funds	107.7	113.6	5.5%

Key Ratios	FY'2022	FY'2023	% points change
Loan to Deposit Ratio	80.1%	82.9%	2.8%
Government Securities to Deposits Ratio	40.9%	41.9%	1.0%
Return on average equity	21.2%	21.0%	(0.2%)
Return on average assets	3.7%	3.6%	(0.1%)
Dividend Yield	12.2%	10.1%	(2.1%)
Dividend Payout Ratio	39.9%	38.0%	(1.9%)

Income Statement	FY'2022 (Kshs bn)	FY'2023 (Kshs bn)	y/y change
Net interest Income	45.5	45.2	(0.6%)
Net non-interest income	25.7	26.5	2.8%
Total Operating income	**71.3**	**71.7**	**0.6%**
Loan loss provision	(8.68)	(6.01)	(30.8%)
Total Operating expenses	(42.2)	(39.7)	(6.1%)
Profit before tax	29.4	32.4	10.0%
Profit after tax	**22.0**	**23.2**	**5.2%**
Core EPS	**3.8**	**4.0**	**5.2%**

Income Statement Ratios	FY'2022	FY'2023	% points change
Yield from interest-earning assets	12.0%	12.4%	0.4%
Cost of funding	3.5%	4.8%	1.3%
Net Interest Margin	8.9%	8.1%	(0.8%)
Net Interest Income as % of operating income	63.9%	63.1%	(0.8%)
Non-Funded Income as a % of operating income	36.1%	36.9%	0.8%
Cost to Income Ratio	59.3%	55.3%	(3.9%)
Cost to Income without LLP	47.1%	47.0%	(0.1%)
Cost to Assets	5.5%	5.0%	(0.5%)

Capital Adequacy Ratios	FY'2022	FY'2023	% points change
Core Capital/Total Liabilities	21.9%	23.4%	1.5%
Minimum Statutory ratio	8.0%	8.0%	
Excess	**13.9%**	**15.4%**	**1.5%**
Core Capital/Total Risk Weighted Assets	16.9%	18.2%	1.3%
Minimum Statutory ratio	10.5%	10.5%	
Excess	**6.4%**	**7.7%**	**1.3%**
Total Capital/Total Risk Weighted Assets	18.0%	22.5%	4.5%
Minimum Statutory ratio	14.5%	14.5%	
Excess	**3.5%**	**8.0%**	**4.5%**
Liquidity Ratio	48.3%	52.0%	3.7%
Minimum Statutory ratio	20.0%	20.0%	
Excess	**28.3%**	**32.0%**	**3.7%**

Income Statement

- Core earnings per share (EPS) increased by 5.2% to Kshs 4.0, from Kshs 3.8 in FY'2022, driven by the 0.6% growth in total operating income to Kshs 71.7 bn, from Kshs 71.3 bn in FY'2022. The performance was also supported by the 6.1% decline in total operating expenses to Kshs 39.7 bn from Kshs 42.2 bn in FY'2022,
- The 0.6% growth in total operating income was mainly driven by a 2.8% growth of Non-Funded Income (NFI) to Kshs 26.5 bn from Kshs 25.7 bn in FY'2022, which supported the 0.6% decrease of Net Interest income to Kshs 45.2 bn in FY'2023, from Kshs 45.5 bn in FY'2022,
- Interest income grew by 11.9% to Kshs 69.1 bn from Kshs 61.8 bn in FY'2022, mainly driven by the 11.0% growth in interest income from loans and advances which increased to Kshs 44.9 bn from Kshs 40.4 bn in FY'2022, coupled with a 129.3% increase in interest income from deposits and placements to Kshs 1.1 bn, from Kshs 0.5 bn in FY'2022. As such, the Yield on Interest-Earning Assets (YIEA) increased to 12.4% from 12.0% recorded in FY'2022, mainly attributable to the faster 11.9% growth in trailing interest income to Kshs XX from Kshs XX in FY'2022, compared to an 8.6% increase in average interest-earning assets to Kshs 556.6 bn, from Kshs 512.7 bn in FY'2022,
- Interest expenses increased by 46.9% to Kshs 23.8 bn from Kshs 16.2 bn in FY'2022, mainly driven by a 26.5% increase in interest expense on customer deposits to Kshs 18.2 bn from Kshs 14.4 bn in FY'2022, coupled with a 215.2% increase in interest expense from other interest expenses to Kshs 4.4 bn in FY'2023 from Kshs 1.4 bn recorded in FY'2022. Consequently, Cost of funds (COF) increased by 1.3% points to 4.8% from 3.5% recorded in FY'2022, owing to the 46.9% increase in Trailing interest expense to Kshs 23.8 bn from Kshs 16.2 bn recorded in FY'2022, compared to a 7.8% increase in average interest-bearing liabilities to Kshs 498.2 bn from Kshs 462.2 bn in FY'2022. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) decreased by 0.8% points to 8.1% from 8.9% in FY'2022, attributable to a 0.6% decline in trailing net interest income to Kshs 45.2 bn from Kshs 45.5 bn recorded in FY'2022 relative to the 8.6% growth in average interest-earning assets,
- Non-Funded Income (NFI) increased by 2.8% to Kshs 26.5 bn from Kshs 25.7 bn in FY'2022, mainly driven by an 8.2% increase in fees and commissions to Kshs 9.1 bn from Kshs 8.4 bn in FY'2022, coupled with a 7.4% increase in other fees and commissions to Kshs 8.5 bn from Kshs 7.9 bn in FY'2022. The growth in NFI was however weighed down by a 25.0% decrease in foreign exchange income to 2.5 bn from 3.3 bn in FY'2022 indicating a decrease in the bank's foreign exchange margins. Total fees and commissions increased by 7.8% to Kshs 17.6 bn, from Kshs 16.3 bn in FY'2022. The revenue mix shifted to 63:37 from 64:36 for the funded to Non-funded income owing to the faster 2.8% growth in Non-Funded income compared to the 0.6% decline in funded income,
- Total operating expenses decreased by 6.1% to Kshs 39.7 bn from Kshs 42.2 bn in FY'2022, driven by a 30.8% decrease in loan loss provisions to Kshs 6.0 bn from Kshs 8.7 bn recorded in FY'2022 reflecting the bank's relaxed management of the credit portfolio, coupled with a 9.6% decrease in other operating expenses to Kshs 17.0 bn from Kshs 18.8 bn in FY'2022. The decrease in provisioning by the bank was despite the rising credit risk as a result deteriorated economic environment as evidenced by the 2023 Purchasing Managers Index (PMI) averaging at 48.1, down from an average of 49.2 in 2022,
- Cost to Income Ratio (CIR) decreased to 53.3% from 59.3% in FY'2022, owing to the 6.1% decrease in total operating expenses, compared to the 0.6% increase in total operating income. Notably, CIR without LLP decreased by 0.1% points to 47.0% from 47.1% recorded in FY'2022, and,
- Profit before tax increased by 10.0% to Kshs 32.4 bn from Kshs 29.4 bn in FY'2022, with the effective tax rate increasing to 30.9% in FY'2023 from 30.0% in FY'2022. As such, profit after tax increased by 5.2% to Kshs 23.2 bn in FY'2023, from Kshs 22.0 bn in FY'2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 10.5% to Kshs 671.1 bn in FY'2023 from Kshs 607.2 bn in FY'2022, driven by a 10.3% expansion of the loan book to Kshs 374.2 bn from Kshs 339.4 bn in FY'2022, coupled with a 173.5% increase in placements to Kshs 27.3 bn, from Kshs 10.0 bn in FY'2022, and the 9.1% increase in government securities to Kshs 189.0 bn, from Kshs 173.3 bn in FY'2022,
- Total liabilities rose by 11.7% to Kshs 557.5 bn from Kshs 499.3 bn in FY'2022, driven by a 6.6% growth in customer deposits to Kshs 451.6 bn, from Kshs 423.8 bn in FY'2022, coupled with a 309.9% increase in placements to Kshs 4.5 bn, from Kshs 1.1 bn in FY'2022,
- The faster 10.3% growth in loans & advances as compared to the 6.6% growth in customer deposits led to an increase in the loan to deposits ratio to 82.9%, from 80.1% in FY'2022,
- The bank's Asset Quality declined, with Gross NPL ratio increasing to 16.2% in FY'2023 from 14.0% in FY'2022, attributable to 27.9% increase in Gross non-performing loans to Kshs 66.9 bn, from Kshs 52.3 bn in FY'2022, compared to the 10.4% increase in gross loans to Kshs 412.5 bn, from Kshs 373.5 bn recorded in FY'2022,
- General Provisions (LLP) increased by 16.5% to Kshs 33.1 bn in FY'2023 from Kshs 28.4 bn in FY'2022. The NPL coverage increased to 57.2% in FY'2023, from 65.1% in FY'2022, attributable to the 27.9% increase in Gross Non-Performing loans (GNPLs) which outpaced the 16.5% increase in general provisions and the 9.2% decrease in interest in suspense to Kshs 5.2 bn from Kshs 5.7 bn in FY'2022Shareholders' funds increased by 5.5% to Kshs 113.6 bn in FY'2023, from Kshs 107.7 bn in FY'2022, supported by a 8.7% increase in retained earnings to Kshs 14.4 bn, from Kshs 13.2 bn in FY'2022,
- Cooperative Bank of Kenya Plc remains capitalized with a core capital to risk-weighted assets ratio of 18.2%, 7.7% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 22.5%, exceeding the statutory requirement of 14.5% by 8.0% points, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.6%, and a Return on Average Equity (ROaE) of 21.0%.

Key Take-Outs:

1. **Sustained earnings growth -** Core earnings per share increased by 5.2% to Kshs 4.0, from Kshs 3.8 in FY'2022, driven by the 0.6% growth in total operating income to Kshs 71.7 bn, from Kshs 71.3 bn in FY'2022,
2. **Asset Growth –** the bank's total assets grew by 10.5% to Kshs 671.1 bn in FY'2023 from Kshs 607.2 bn in FY'2022, driven by a 10.3% expansion of the loan book to Kshs 374.2 bn from Kshs 339.4 bn in FY'2022,
3. **Declined asset quality –** The bank's Gross NPL ratio increasing to 16.2% in FY'2023 from 14.0% in FY'2022, attributable to 27.9% increase in Gross non-performing loans to Kshs 66.9 bn, from Kshs 52.3 bn in FY'2022, compared to the 10.4% increase in gross loans to Kshs 412.5 bn, from Kshs 373.5 bn recorded in FY'2022,
4. **Improved Efficiency –** Cost to Income Ratio (CIR) decreased to 53.3% from 59.3% in FY'2022, owing to the 6.1% decrease in total operating expenses, compared to the 0.6% increase in total operating income. Notably, CIR without LLP decreased by 0.1% points to 47.0% from 47.1% recorded in FY'2022,
5. **Exposure to Government Securities –** the bank registered a 9.1% increase in investment securities to Kshs 189.0 bn, from Kshs 173.3 bn in FY'2022, taking advantage of the high yield offered by the government on their securities during the year, and,
6. **Dividend Payment –** Dividends paid remained unchanged at Kshs 1.5 in FY'2023, as were issued in FY'2022 translating to a dividend yield of 10.7% and a dividend payout ratio of 38.0% in 2023 compared to a dividend yield of 12.2% and a dividend payout ratio of 39.9% in 2022.

Going forward, the factors that would drive the bank's growth would be:

- **Strong Customer Base** – Cooperative Bank still retains a loyal yet diverse customer base that includes cooperatives, SMEs, retail customers, and government institutions. We anticipate that the bank will keep leveraging on this base to improve its loan book which this year expanded by 10.3% to Kshs 374.2 bn from Kshs 339.4 bn in FY'2022.
- **Diversified products –** The bank has in recent days launched a number of products and continues to simultaneously offer differentiated products for diaspora bankers, micro and small enterprises, home and vehicle insurance, bancassurance and the Sacco Mco-op cash. This diversification is expected to continue improving the Non-funded Income of the bank which this year came in at 26.5 bn, a 2.8% increase from Kshs 25.7 bn in FY'2022, and,
- **Digital Expansion -** The lender's continued diversification through its digital platforms like Mco-op Cash is set to continue increasing usage owing to the convenience of payment services as well as money transfers. As of FY'2022, only 8.0% of all transactions happened at the branch while the rest were all digital transactions.

Valuation Summary

- We are of the view that Cooperative Bank of Kenya is a "buy" with a target price of Kshs 16.8 representing an upside of 21.5%, from the current price of 14.9 as of 22nd March 2024, inclusive of a dividend yield of 10.7%.
- Cooperative Bank of Kenya is currently trading at a P/TBV of 0.8x and a P/E of 3.8x vs an industry average of 0.8x and 4.0x respectively.