Cytonn INVESTMENTS

Co-operative Bank – H1’2023

18th June, 2023

Below is a summary of Co-operative Bank H1’2023 performance:

Balance Sheet Items	H1'2022	H1'2023	y/y change
Government Securities	183.2	188.5	2.9%
Net Loans and Advances	330.1	365.4	10.7%
Total Assets	603.9	664.9	10.1%
Customer Deposits	423.0	463.9	9.7%
Total Liabilities	506.9	556.4	9.8%
Shareholders Funds	96.7	108.3	11.9%

Balance Sheet Ratios	H1'2022	H1'2023	y/y change
Loan to Deposit Ratio	78.0%	78.8%	0.7%
Return on average equity	21.8%	22.2%	0.3%
Return on average assets	3.5%	3.6%	0.1%

Income Statement	H1'2022	H1'2023	y/y change
Net Interest Income	21.1	21.5	2.3%
Non-Interest Income	13.3	13.8	4.0%
Total Operating income	**34.4**	**35.4**	**3.0%**
Loan Loss provision	(3.34)	(2.86)	(14.4%)
Total Operating expenses	(19.2)	(19.1)	(0.1%)
Profit before tax	15.3	16.4	7.4%
Profit after tax	**11.5**	**12.1**	**5.9%**
Earning per share	**2.0**	**2.1**	**5.9%**

Income Statement Ratios	H1'2022	H1'2023	% point change
Yield from interest-earning assets	11.4%	11.6%	0.3%
Cost of funding	3.2%	3.8%	0.6%
Net Interest Spread	8.2%	7.8%	(0.3%)
Net Interest Income as % of operating income	61.3%	60.9%	(0.4%)
Non-Funded Income as a % of operating income	38.7%	39.1%	0.4%
Cost to Income	55.8%	54.1%	(1.7%)
CIR without provisions	46.0%	46.0%	0.0%
Cost to Assets	2.6%	2.5%	(0.2%)
Net Interest Margin	8.4%	8.2%	(0.2%)

Capital Adequacy Ratios	H1'2022	H1'2023	% points change
Core Capital/Total deposit Liabilities	19.7%	21.2%	1.5%
Minimum Statutory ratio	8.0%	8.0%	
Excess	**11.7%**	**13.2%**	**1.5%**
Core Capital/Total Risk Weighted Assets	15.5%	16.5%	1.0%
Minimum Statutory ratio	10.5%	10.5%	
Excess	**5.0%**	**6.0%**	**1.0%**
Total Capital/Total Risk Weighted Assets	16.6%	20.5%	3.9%
Minimum Statutory ratio	14.5%	14.5%	
Excess	**2.1%**	**6.0%**	**3.9%**
Liquidity Ratio	44.5%	52.3%	7.8%
Minimum Statutory ratio	20.0%	20.0%	
Excess	**24.5%**	**32.3%**	**7.8%**

Income Statement

- Core earnings per share grew by 5.9% to Kshs 2.1, from Kshs 2.0 in H1’2022, driven by the 3.0% growth in total operating income to Kshs 35.4 bn, from Kshs 34.4 bn in H1’2022.
- The 3.0% growth in total operating income was mainly driven by a 4.0% growth in Non Interest Income to Kshs 13.8 bn from Kshs 13.3 bn in H1’2022, coupled with a 2.3% growth in Net Interest Income (NII) to Kshs 21.5 bn, from Kshs 21.1 bn in H1’2022,
- Interest income grew by 12.0% to Kshs 32.0 bn from Kshs 28.6 bn in H1’2022, mainly driven by a 13.6% growth in interest income from loans and advances to Kshs 21.0 bn from Kshs 18.5 bn in H1’2022. As such, the Yield on Interest-Earning Assets (YIEA) increased to 11.6% from 11.4% recorded in H1’2022, mainly attributable to the faster 12.0% growth in interest income compared to a relatively lower 9.3% increase in average interest earning assets to Kshs 559.7 bn, from Kshs 512.3 bn in H1’2022,
- Interest expenses rose by 38.9% to Kshs 10.4 bn from Kshs 7.5 bn in H1’2022, driven by 22.7% increase in interest expense on customer deposits to Kshs 8.3 bn from Kshs 6.8 bn in H1’2022, coupled with a 181.3% increase in other interest expenses to Kshs 2.0 bn in H1’2023 from Kshs 0.7 bn recorded in H1’2022. Consequently, Cost of funds (COF) increased by 0.6% points to 3.8% from 3.2% recorded in H1’2022, owing to a faster 27.6% increase in Trailing interest expense to Kshs 19.2 bn from Kshs 15.0 bn recorded in H1’2022, compared to a slower 7.6% increase in average interest bearing liabilities to Kshs 501.1 bn from Kshs 465.8 bn in H1’2022.Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) decreased by 0.2% points to 8.2% from 8.4% in H1’2022, attributable to an 9.3% increase in average interest earning assets which outpaced the 6.4% increase in trailing net interest income to Kshs 46.0 bn from Kshs 43.3 bn recorded in H1’2022,
- Non-Funded Income (NFI) increased by 4.0% to Kshs 13.8 bn from Kshs 13.3 bn in H1’2022, mainly driven by a 13.3% increase in fees and commissions on loans and advances to Kshs 6.2 bn, from Kshs 5.5 bn in H1’2022. However the increase was weighed down by a 10.0% decrease in foreign exchange trading income to Kshs 1.8 bn from Kshs 2.0 bn. Total fees and commissions increase by 8.4% to Kshs 11.8 bn, from Kshs 10.9 bn in H1’2022. The revenue mix remained unchanged at 61:39 for the Funded to Non-funded income owing to fairly close increase margins of 2.3% and 4.0% For funded and Non Funded income respectively,
- Total operating expenses decreased by 0.1% to Kshs 19.1 bn from Kshs 19.2 bn in H1’2022, driven by 14.4% decrease in loan loss provisions to Kshs 2.9 bn from Kshs 3.3 bn recorded in H1’2022, coupled with a 4.9% decrease in other expenses to Kshs 8.3 bn from Kshs 8.7 bn in H1’2022, which outpaced the 12.6% increase in staff costs to Kshs 8.0 bn, from Kshs 7.1 bn in H1’2022,
- Cost to Income Ratio (CIR) decreased by 1.7% points, to 54.1% from 55.8% in H1’2022, owing to the 3.0% increase in total operating income, compared to the 0.1% decrease in total operating expense. Notably, CIR without LLP remained unchanged at 46.0% for the two periods under review, and,
- Profit before tax increased by 7.4% to Kshs 16.4 bn from Kshs 15.3 bn in H1’2022, with effective tax rate remaining unchanged at 29.0%, leading to an 5.9% increase in profit after tax to Kshs 12.1 bn in H1’2023, from Kshs 11.5 bn in H1’2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 10.1% to Kshs 664.9 bn, from Kshs 603.9 bn in H1’2022, driven by a 10.7% loan book expansion to Kshs 365.4 bn, from Kshs 330.1 bn in H1’2022, coupled with a 2.9% increase investment in government securities to Kshs 188.5 bn from Kshs 183.2 bn in H1’2022,
- Total liabilities rose by 9.8% to Kshs 556.4 bn from Kshs 506.9 bn in H1’2022, driven by a 9.7% growth in customer deposits to Kshs 463.9 bn, from Kshs 423.0 bn in H1’2022, coupled with a 43.6% increase in borrowings to 59.4 bn from Kshs 41.4 bn recorded in H1’2022.
- The faster 10.7% growth in loans as compared to the 9.7% growth in deposit led to an increase in the loan to deposits ratio to 78.8%, from 78.0% in H1’2022,

- The bank’s Asset Quality deteriorated, with Gross NPL ratio increasing to 14.6% in H1’2023 from 14.1% in H1’2022, attributable to 14.2% increase in Gross non-performing loans to Kshs 58.4 bn, from Kshs 51.2 bn in H1’2022, compared to the 10.2% increase in gross loans to Kshs 400.9 bn, from Kshs 363.8 bn recorded in H1’2022,
- General Provisions (LLP) increased by 5.4% to Kshs 29.2 bn in H1’2023 from Kshs 27.7 bn in H1’2022. The NPL coverage decreased to 60.7% in H1’2023, from 65.8% in H1’2022, attributable to the 14.2% increase in gross non-performing loans which outpaced the 4.9% increase in interest in suspense to Kshs 6.3 bn from 6.0 bn in H1’2022 coupled with the 5.4% increase in General Provisions.
- Shareholders’ funds increased by 11.9% to Kshs 108.3 bn in H1’2023, from Kshs 96.7 bn in H1’2022, supported by a 15.0% increase in retained earnings to Kshs 109.8 bn, from Kshs 95.5 bn in H1’2022,
- Co-operative bank remains capitalized with a core capital to risk-weighted assets ratio of 16.5%, 6.0% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 20.5%, exceeding the statutory requirement of 14.5% by 6.0% points, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.6%, and a Return on Average Equity (ROaE) of 22.2%.

Key Take-Outs:

1. **Earnings growth -** Core earnings per share (EPS) grew by 5.9% to Kshs 2.1, from Kshs 2.0 in H1’2022, driven by the 3.0% growth in total operating income to Kshs 35.4 bn, from Kshs 34.4 bn in H1’2022.

- **Improved efficiency –** The bank’s total operating expenses decreased by 0.1% to Kshs 19.1 bn in H1’2023 from Kshs 19.2 bn in H1’2022, attributable to a 14.4% decrease in loan loss provisions to Kshs 2.9 bn, from Kshs 3.3 bn recorded in H1’2022, coupled with a 4.9% decrease in other expenses to Kshs 8.3 bn from Kshs 8.7 bn in H1’2022, which outpaced the slower 12.6% increase in staff costs to Kshs 8.0 bn, from Kshs 7.1 bn in H1’2022,
- **Asset quality Deterioration-** The bank’s asset quality deteriorated as evidenced by the NPL ratio increasing to 14.6% in H1’2023 from 14.1% in H1’2022, attributable to 14.2% increase in Gross non-performing loans to Kshs 58.4 bn, from Kshs 51.2 bn in H1’2022, compared to the 10.2% increase in gross loans to Kshs 400.9 bn, from Kshs 363.8 bn recorded in H1’2022,

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

- **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 in payment services as well as money transfer. As of FY’2022, ony 8.0% of all transactions happened at the branch while the rest were all digital transactions. In turn, the Non- Funded Income has continued to grow, registering a 4.0% growth to Kshs 13.8 bn in H1’2023 from Kshs 13.3 bn in H1’2022.

Valuation Summary

- We are of the view that Stanbic bank is a “buy” with a target price of Kshs 14.9 representing an upside of 30.0%, from the current price of 11.5 as of 18th August 2023, inclusive of a dividend yield of 13.1%.
- Co-operative Bank is currently trading at a P/TBV of 0.6x and a P/E of 3.3x vs an industry average of 0.8x and 3.8x respectively.