

Below is a summary of Co-operative Bank's Q1'2024 performance:

Balance Sheet Items	Q1'2023	Q1'2024	y/y change
Government Securities	179.2	200.2	11.7%
Net Loans and Advances	360.1	378.1	5.0%
Total Assets	631.1	714.7	13.2%
Customer Deposits	419.8	481.8	14.8%
Total Liabilities	518.2	589.0	13.7%
Shareholders Funds	112.6	127.1	12.9%

Balance Sheet Ratios	Q1'2023	Q1'2024	% points change
Loan to Deposit Ratio	85.8%	78.5%	(7.3%)
Government Securities to Deposits Ratio	42.7%	41.6%	(1.1%)
Return on average equity	20.7%	19.7%	(1.0%)
Return on average assets	3.6%	3.5%	(0.1%)

Income Statement	Q1'2023	Q1'2024	y/y change
Net Interest Income	10.8	11.7	8.6%
Non-Interest Income	7.1	7.1	(0.3%)
Total Operating income	17.9	18.8	5.1%
Loan Loss provision	(1.5)	(1.6)	3.9%
Total Operating expenses	(9.8)	(9.9)	0.5%
Profit before tax	8.1	9.0	10.6%
Profit after tax	6.1	6.6	7.7%
Core EPS	1.0	1.1	7.7%

Income Statement Ratios	Q1'2023	Q1'2024	% points Change
Yield from interest-earning assets	11.7%	12.3%	0.6%
Cost of funding	3.7%	5.1%	1.4%
Net Interest Spread	8.1%	7.3%	(0.8%)
Net Interest Income as % of operating income	60.3%	62.3%	2.0%
Non-Funded Income as a % of operating income	39.7%	37.7%	(2.0%)
Cost to Income	54.9%	52.5%	(2.4%)
CIR without provisions	46.3%	44.1%	(2.3%)
Cost to Assets	1.3%	1.2%	(0.1%)
Net Interest Margin	8.5%	7.8%	(0.7%)

Capital Adequacy Ratios	Q1'2023	Q1'2024	% points change
Core Capital/Total deposit Liabilities	22.7%	22.3%	(0.4%)
Minimum Statutory ratio	8.0%	8.0%	
Excess	14.7%	14.3%	(0.4%)
Core Capital/Total Risk Weighted Assets	16.3%	18.2%	1.9%
Minimum Statutory ratio	10.5%	10.5%	
Excess	5.8%	7.7%	1.9%
Total Capital/Total Risk Weighted Assets	17.2%	21.6%	4.4%
Minimum Statutory ratio	14.5%	14.5%	
Excess	2.7%	7.1%	4.4%
Liquidity Ratio	50.6%	52.0%	1.4%
Minimum Statutory ratio	20.0%	20.0%	
Excess	30.6%	32.0%	1.4%

Income Statement

- Core earnings per share grew by 7.7% to Kshs 1.1, from Kshs 1.0 in Q1'2023, driven by the 5.1% increase in total operating income to Kshs 18.8 bn, from Kshs 17.9 bn in Q1'2023. However, the performance was weighed down by a 0.5% increase in total operating expenses to Kshs 9.9 bn from Kshs 9.8 bn in Q1'2023,
- The 5.1% increase in total operating income was mainly driven by the 8.6% increase in Net Interest Income (NII) to Kshs 11.7 bn from Kshs 10.8 bn in Q1'2023, which outpaced the 0.3% decline in Non Funded Income (NFI) to remain relatively unchanged at Kshs 7.1 bn Q1'2023,
- Interest income grew by 24.7% to Kshs 19.4 bn from Kshs 15.6 bn in Q1'2023, mainly driven by a 24.2% growth in interest income from loans and advances to Kshs 12.5 bn from Kshs 10.0 bn in Q1'2023, coupled with a 21.4% increase in interest income from government securities to Kshs 6.2 bn, from Kshs 5.1 bn in Q1'2023. As such, the Yield on Interest-Earning Assets (YIEA) increased to 12.3% from 11.7% recorded in Q1'2023, mainly attributable to the faster 24.7% growth in interest income compared to a 9.5% increase in average interest earning assets to Kshs 590.9 bn, from Kshs 539.8 bn in Q1'2023,
- Interest expenses rose by 60.8% to Kshs 7.7 bn from Kshs 4.8 bn in Q1'2023, mainly driven by a 61.9% increase in interest expense on customer deposits to Kshs 6.4 bn from Kshs 3.9 bn in Q1'2023, coupled with a 34.7% increase in interest expense from other interest expenses to Kshs 1.0 bn from Kshs 0.8 bn in. Consequently, Cost of funds (COF) increased by 1.4% points to 5.1% from 3.7% recorded in Q1'2023, owing to a faster 91.5% increase in Trailing interest expense to Kshs 26.8 bn from Kshs 17.4 bn recorded in Q1'2023, compared to a 10.6% increase in average interest-bearing liabilities to Kshs 525.8 bn from Kshs 475.2 bn in Q1'2023. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) decreased by 0.7% points to 7.8% from 8.5% in Q1'2023, attributable to a 0.5% increase in trailing net interest income to Kshs 46.2 bn from Kshs 45.9 bn recorded in Q1'2023 which was, however, outpaced the 9.5% growth in average interest earning assets,
- Non-Funded Income (NFI) decreased slightly by 0.3% to remain relatively unchanged from the Kshs 7.1 bn recorded in Q1'2023, mainly driven by a 14.7% decrease in fees and commissions on loans to Kshs 2.9 bn, from Kshs 3.4 bn in Q1'2023, which outpaced the 2.7% increase in income from other fees and commissions to Kshs 2.6 bn, from 2.5 bn in Q1'2023. Forex trading income increased by 30.8% to Kshs 1.4 bn, from Kshs 1.1 bn in Q1'2023. The revenue mix shifted to 62:38 from 60:40 for the funded to Non-funded income owing to the 24.7% growth in Funded Income compared to a 0.3% decrease in the Non Funded Income,
- Total operating expenses increased by 0.5% to Kshs 9.9 bn from Kshs 9.8 bn in Q1'2023, driven by 12.6% increase in staff costs to Kshs 4.5 bn from Kshs 4.0 bn recorded in Q1'2023, coupled with a 3.9% increase in loan loss provisions to Kshs 1.6 bn from Kshs 1.5 bn recorded in Q1'2023, which outpaced the 11.9% decrease in other operating expenses to Kshs 3.8 bn from Kshs 4.3 bn recorded in Q1'2023. The increase in provisioning is partly attributable to sustained credit risk despite improvement in the economic environment as evidenced by the Q1'2024 Purchasing Managers Index (PMI) which averaged 50.3, up from an average of 49.3 in Q1'2023,
- Cost to Income Ratio (CIR) decreased by 2.4% points to 52.5% from 54.9% in Q1'2023, owing to the 0.5% increase in total operating expenses, which was outpaced by the 5.1% increase in total operating income. Notably, CIR without LLP decreased by 2.3% points to 44.1% from 46.3% recorded in Q1'2023, and,
- Profit before tax decreased marginally by 10.6% to Kshs 9.0 bn from Kshs 8.1 bn recorded in Q1'2023, with effective tax rate decreasing to 27.6% in Q1'2024 from 29.0% in Q1'2023, leading to a 7.7% increase in profit after tax to Kshs 6.6 bn in Q1'2024, from Kshs 6.1 bn in Q1'2023.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 13.2% to Kshs 714.7 bn, from Kshs 631.1 bn in Q1'2023, driven by a 5.0% increase in net loans and advances to Kshs 378.1 bn, from Kshs 360.1 bn in Q1'2023, coupled with the 11.7% increase in investment in government securities to Kshs 200.2 bn, from Kshs 179.2 bn in Q1'2023,

- Total liabilities rose by 13.7% to Kshs 589.0 bn from Kshs 518.2 bn in Q1'2024, driven by a 14.8% growth in customer deposits to Kshs 481.8 bn, from Kshs 419.8 bn in Q1'2023, coupled with a 24.1% increase in borrowings to 60.1 bn from Kshs 48.4 bn recorded in Q1'2023, which outpaced the 8.9% decline in placements to Kshs 19.8 bn, from Kshs 21.8 bn in Q1'2023,
- The faster 14.8% growth in customer deposits as compared to the 5.0% growth in loans led to a decrease in the loan to deposits ratio to 78.5%, from 85.8% in Q1'2023,
- The bank's Asset Quality declined, with Gross NPL ratio increasing to 15.9% in Q1'2024, from 14.1% in Q1'2023, attributable to 19.4% increase in Gross non-performing loans to Kshs 66.5 bn, from Kshs 55.7 bn in Q1'2023, compared to the 5.7% increase in gross loans to Kshs 417.1 bn, from Kshs 394.7 bn recorded in Q1'2023,
- General Provisions (LLP) increased by 19.1% to Kshs 33.8 bn in Q1'2024 from Kshs 28.4 bn in Q1'2023. The NPL coverage decreased to 58.6% in Q1'2024, from 62.2% in Q1'2023, attributable to the 19.4% increase in Gross non-performing loans to Kshs 66.5 bn, from Kshs 55.7 bn in Q1'2023, which outpaced the 19.1% increase in general provisions and a 17.3% decrease interest in suspense to Kshs 5.1 bn, from Kshs 6.2 bn in Q1'2023,
- Shareholders' funds increased by 12.9% to Kshs 127.1 bn in Q1'2024, from Kshs 112.6 bn in Q1'2023, supported by a 7.7% increase in retained earnings to Kshs 6.6 bn, from Kshs 6.1 bn in Q1'2023,
- Cooperative bank 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 21.6%, exceeding the statutory requirement of 14.5% by 7.1% points, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.5%, and a Return on Average Equity (ROaE) of 19.7%.

Key Take-Outs:

1. **Increased earnings** - Core earnings per share (EPS) grew by 7.7% to Kshs 1.1, from Kshs 1.0 in Q1'2023, driven by the 24.2% growth in funded income to Kshs 12.5 bn from Kshs 10.0 bn in Q1'2023,
2. **Declined asset quality** – The bank's gross NPL ratio increased to 15.9% in Q1'2024, from 14.1% in Q1'2023, 19.4% increase in Gross non-performing loans to Kshs 66.5 bn, from Kshs 55.7 bn in Q1'2023, compared to the 5.7% increase in gross loans to Kshs 417.1 bn, from Kshs 394.7 bn recorded in Q1'2023,
3. **Expanded Balanced sheet** - The balance sheet recorded an expansion as total assets grew by 13.2% to Kshs 714.7 bn, from Kshs 631.1 bn in Q1'2024, driven by a 5.0% increase in net loans and advances to Kshs 378.1 bn, from Kshs 360.1 bn in Q1'2023, coupled with an 11.7% increase in investment in government securities to Kshs 200.2 bn, from Kshs 179.2 bn in Q1'2023.

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, and,
- **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.

Valuation Summary

- We are of the view that Co-operative Bank is a “buy” with a target price of Kshs 17.2 representing an upside of 34.9%, from the current price of 12.8 as of 17th May 2024, inclusive of a dividend yield of 11.8% and,
- Co-operative Bank is currently trading at a P/TBV of 0.6x and a P/E of 3.2x vs an industry average of 0.8x and 3.6x respectively.