

Below is a summary of Co-operative Bank Q3'2023 performance:

Balance Sheet Items	Q3'2022	Q3'2023	y/y change
Government Securities	182.4	185.1	1.5%
Net Loans and Advances	335.2	378.1	12.8%
<b>Total Assets</b>	<b>622.1</b>	<b>661.3</b>	<b>6.3%</b>
Customer Deposits	432.0	432.8	0.2%
Total Liabilities	520.9	553.2	6.2%
<b>Shareholders Funds</b>	<b>100.9</b>	<b>108.1</b>	<b>7.1%</b>

Balance Sheet Ratios	Q3'2022	Q3'2023	y/y change
Loan to Deposit Ratio	77.6%	87.3%	9.8%
Return on average equity	22.5%	22.3%	(0.1%)
Return on average assets	3.6%	3.6%	0.0%

Income Statement	Q3'2022	Q3'2023	y/y change
Net Interest Income	32.0	32.8	2.5%
Non-Interest Income	20.2	20.6	2.1%
<b>Total Operating income</b>	<b>52.2</b>	<b>53.4</b>	<b>2.3%</b>
Loan Loss provision	(5.73)	(4.21)	(26.5%)
<b>Total Operating expenses</b>	<b>(29.6)</b>	<b>(29.0)</b>	<b>(2.1%)</b>
Profit before tax	22.7	24.7	8.6%
<b>Profit after tax</b>	<b>17.1</b>	<b>18.4</b>	<b>7.6%</b>
<b>Earning per share</b>	<b>2.9</b>	<b>3.1</b>	<b>7.6%</b>

Income Statement Ratios	Q3'2022	Q3'2023	Y/Y Change
Yield from interest-earning assets	11.4%	12.2%	0.8%
Cost of funding	3.2%	4.2%	1.0%
Net Interest Spread	8.2%	8.0%	(0.2%)
Net Interest Income as % of operating income	61.4%	61.5%	0.1%
Non-Funded Income as a % of operating income	38.6%	38.5%	(0.1%)
Cost to Income	56.8%	54.3%	(2.5%)
CIR without provisions	45.8%	46.4%	0.6%
Cost to Assets	3.84%	3.75%	(0.1%)
Net Interest Margin	8.5%	8.4%	(0.1%)

Capital Adequacy Ratios	Q3'2022	Q3'2023	% points change
Core Capital/Total deposit Liabilities	19.7%	23.1%	3.4%
Minimum Statutory ratio	8.0%	8.0%	
<b>Excess</b>	<b>11.7%</b>	<b>15.1%</b>	<b>3.4%</b>
Core Capital/Total Risk Weighted Assets	15.7%	17.9%	2.2%
Minimum Statutory ratio	10.5%	10.5%	
<b>Excess</b>	<b>5.2%</b>	<b>7.4%</b>	<b>2.2%</b>
Total Capital/Total Risk Weighted Assets	16.8%	22.1%	5.3%
Minimum Statutory ratio	14.5%	14.5%	
<b>Excess</b>	<b>2.3%</b>	<b>7.6%</b>	<b>5.3%</b>
Liquidity Ratio	52.1%	50.3%	(1.8%)
Minimum Statutory ratio	20.0%	20.0%	
<b>Excess</b>	<b>32.1%</b>	<b>30.3%</b>	<b>(1.8%)</b>

## Income Statement

- Core earnings per share grew by 7.6% to Kshs 3.1, from Kshs 2.9 in Q3'2022, driven by the 2.3% growth in total operating income to Kshs 53.4 bn, from Kshs 52.2 bn in Q3'2022.
- The 2.3% growth in total operating income was mainly driven by a 2.5% growth in Net Interest Income to Kshs 32.8 bn from Kshs 32.0 bn in Q3'2022, coupled with a 2.1% growth in Non Interest Income (NII) to Kshs 20.6 bn, from Kshs 20.2 bn in Q3'2022,
- Interest income grew by 12.9% to Kshs 49.4 bn from Kshs 43.7 bn in Q3'2022, mainly driven by a 14.3% growth in interest income from loans and advances to Kshs 31.4 bn from Kshs 27.9 bn in Q3'2022. As such, the Yield on Interest-Earning Assets (YIEA) increased to 12.2% from 11.4% recorded in Q3'2022, mainly attributable to the faster 12.9% growth in interest income compared to a relatively lower 5.3% increase in average interest earning assets to Kshs 551.9 bn, from Kshs 523.9 bn in Q3'2022,
- Interest expenses rose by 41.3% to Kshs 16.5 bn from Kshs 11.7 bn in Q3'2022, driven by 27.5% increase in interest expense on customer deposits to Kshs 13.4 bn from Kshs 10.5 bn in Q3'2022, coupled with a 127.7% increase in other interest expenses to Kshs 2.6 bn in Q3'2023 from Kshs 1.1 bn recorded in Q3'2022. Consequently, Cost of funds (COF) increased by 1.0% points to 4.2% from 3.2% recorded in Q3'2022, owing to a faster 36.7% increase in Trailing interest expense to Kshs 21.1 bn from Kshs 15.4 bn recorded in Q3'2022, compared to a slower 5.0% increase in average interest bearing liabilities to Kshs 500.3 bn from Kshs 476.3 bn in Q3'2022. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) decreased by 0.1% points to 8.4% from 8.5% in Q3'2022, attributable to the faster 5.3% increase in average interest earning assets which outpaced the 4.3% increase in trailing net interest income to Kshs 46.3 bn from Kshs 44.4 bn recorded in Q3'2022,
- Non-Funded Income (NFI) increased by 2.1% to Kshs 20.6 bn from Kshs 20.2 bn in Q3'2022, mainly driven by a 8.2% increase in fees and commissions on loans and advances to Kshs 9.1 bn, from Kshs 8.4 bn in Q3'2022, coupled with a 7.4% increase in other fees and commissions to Kshs 8.5 bn, from Kshs 7.9 bn in Q3'2022. However the increase was weighed down by a 25.0% decrease in foreign exchange trading income to Kshs 2.5 bn from Kshs 3.3 bn. Total fees and commissions increased by 7.8% to Kshs 17.6 bn, from Kshs 16.3 bn in Q3'2022. The revenue mix remained unchanged at 61:39 for the Funded to Non-funded income owing to fairly close increase margins of 2.5% and 2.1% For funded and Non Funded income respectively,
- Total operating expenses decreased by 2.1% to Kshs 29.0 bn from Kshs 29.6 bn in Q3'2022, driven by 26.5% decrease in loan loss provisions to Kshs 4.2 bn from Kshs 5.7 bn recorded in Q3'2022, coupled with a 3.5% decrease in other expenses to Kshs 12.6 bn from Kshs 13.1 bn in Q3'2022, which outpaced the 12.4% increase in staff costs to Kshs 12.2 bn, from Kshs 10.8 bn in Q3'2022,
- Cost to Income Ratio (CIR) decreased by 2.5% points, to 54.3% from 56.8% in Q3'2022, owing to the 2.3% increase in total operating income, compared to the 2.1% decrease in total operating expense. Notably, CIR without LLP increased by 0.6% points, to 46.4%, from 45.8% in Q3'2023, and,
- Profit before tax increased by 8.6% to Kshs 24.7 bn from Kshs 22.7 bn in Q3'2022, with effective tax rate reducing to 28.5%, from 28.8% in Q3'2022, leading to a 7.6% increase in profit after tax to Kshs 18.4 bn in Q3'2023, from Kshs 17.1 bn in Q3'2022.

### **Balance Sheet**

- The balance sheet recorded an expansion as total assets grew by 6.3% to Kshs 661.3 bn, from Kshs 622.1 bn in Q3'2022, driven by a 12.8% loan book expansion to Kshs 378.1 bn, from Kshs 335.2 bn in Q3'2022, coupled with a 1.5% increase investment in government securities to Kshs 185.1 bn from Kshs 182.4 bn in Q3'2022,
- Total liabilities rose by 6.2% to Kshs 553.2 bn from Kshs 520.9 bn in Q3'2022, driven by a 56.5% growth in borrowings to Kshs 65.6 bn, from Kshs 41.9 bn in Q3'2022, coupled with a 69.1% increase in placements to 17.7 bn from Kshs 10.5 bn recorded in Q3'2022.
- Notably, customer deposits recorded a minimal growth of 0.2%, to Kshs 432.8 bn from Kshs 432.0 bn in Q3'2022. The slower 0.2% growth in deposits as compared to the 12.8% growth in loans led to an increase in the loan to deposits ratio to 87.3%, from 77.6% in Q3'2022,

- The bank's Asset Quality deteriorated, with Gross NPL ratio increasing to 14.9% in Q3'2023 from 14.0% in Q3'2022, attributable to 19.5% increase in Gross non-performing loans to Kshs 61.9 bn, from Kshs 51.8 bn in Q3'2022, compared to the slower 12.3% increase in gross loans to Kshs 416.6 bn, from Kshs 371.1 bn recorded in Q3'2022,
- General Provisions (LLP) increased by 10.2% to Kshs 32.9 bn in Q3'2023 from Kshs 29.8 bn in Q3'2022. The NPL coverage decreased to 62.1% in Q3'2023, from 69.3% in Q3'2022, attributable to the 19.5% increase in gross non-performing loans which outpaced the 8.1% decrease in interest in suspense to Kshs 5.6 bn from 6.1 bn in Q3'2022 coupled with the 10.2% increase in General Provisions.
- Shareholders' funds increased by 7.1% to Kshs 108.1 bn in Q3'2023, from Kshs 100.9 bn in Q3'2022, supported by a 14.7% increase in retained earnings to Kshs 115.9 bn, from Kshs 101.0 bn in Q3'2022,
- Co-operative bank remains capitalized with a core capital to risk-weighted assets ratio of 17.9%, 7.4% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 22.1%, exceeding the statutory requirement of 14.5% by 7.6% points, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.6%, and a Return on Average Equity (ROaE) of 22.3%.

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

1. **Earnings growth** - Core earnings per share (EPS) grew by 7.6% to Kshs 3.1, from Kshs 2.9 in Q3'2022, driven by the 2.3% growth in total operating income to Kshs 53.4 bn, from Kshs 52.2 bn in Q3'2022.
- **Improved efficiency** – The bank's total operating expenses decreased by 2.1% to Kshs 29.0 bn in Q3'2023 from Kshs 29.6 bn in Q3'2022, attributable to a 26.5% decrease in loan loss provisions to Kshs 4.2 bn, from Kshs 5.7 bn recorded in Q3'2022, coupled with a 3.5% decrease in other expenses to Kshs 12.6 bn from Kshs 13.1 bn in Q3'2022, which outpaced the slower 12.4% increase in staff costs to Kshs 12.2 bn, from Kshs 10.8 bn in Q3'2022,
- **Asset quality Deterioration**- The bank's asset quality deteriorated as evidenced by the NPL ratio increasing to 14.9% in Q3'2023 from 14.0% in Q3'2022, attributable to 19.5% increase in Gross non-performing loans to Kshs 61.9 bn, from Kshs 51.8 bn in Q3'2022, compared to the slower 12.3% increase in gross loans to Kshs 416.6 bn, from Kshs 371.1 bn recorded in Q3'2022,

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, only 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 2.1% growth to Kshs 20.6 bn in Q3'2023 from Kshs 20.2 bn in Q3'2022

#### **Valuation Summary**

- We are of the view that Co-operative bank is a "buy" with a target price of Kshs 14.9 representing an upside of 28.6%, from the current price of 11.6 as of 17<sup>th</sup> November 2023, inclusive of a dividend yield of 12.9%.
- Co-operative Bank is currently trading at a P/TBV of 0.6x and a P/E of 2.9x vs an industry average of 0.8x and 3.7x respectively.