

**Valuation Summary**

- We recommend a Lighten for the Co-operative Bank stock with a target price of Kshs 18 representing a downside of 2.3%, from the current price of Kshs 18.4, as at Wednesday, 18<sup>th</sup> May 2016, inclusive of a dividend yield of 4.3%
- Co-operative Bank is currently trading at a P/B of 1.5x and a P/E of 8.0x, versus an industry average of 1.6x and 7.5x, respectively

**Key highlights during the quarter**

- The project Eagle is in its implementation phase anchored on branch transformation, sales force effectiveness as well as improved credit management system
- The Group embraced use of data analytics to generate sales from leads.

**Income Statement**

- Core earnings per share grew by 7.7% to Kshs 0.70 per share in Q1'2016 from Kshs 0.65 per share in Q1'2015, driven by a 17.7% growth in operating revenue in Q1'2016 which was outpaced by a 21.7% rise in operating expenses in Q1'2016
- Operating revenue grew by 17.7% to Kshs 10.3 bn in Q1'2016 from Kshs 8.7 bn in Q1'2015 driven by a 30.6% growth in net interest income, which was supported by a 16.1% growth in loans and advances. Net interest margin decreased to 10.0% in Q1'2016 from 10.2% in Q1'2015. Interest expenses rose by 67.0% to Kshs 3.9 bn in Q1'2016 from Kshs 2.3 bn in Q1'2015 supported by an 11.9% growth in deposits. The rise in interest expenses highlights the high cost of deposits during the quarter, a spill over from 2015
- Non-funded income recorded an increase of 20.7% to Kshs 3.5 bn from Kshs 2.9 bn in Q1'2015. This growth was supported by (i) a 343.5% growth in other incomes to Kshs 538.7 mn from Kshs 121.5 mn in Q1'2015, (ii) a 10.0% growth in foreign exchange gains to Kshs 498.0 mn from Kshs 452.7 mn, and (iii) a 5.7% growth in fees and commissions to 2.4 bn from 2.3 bn in Q1'2015. The group continues to embrace alternative channels of distribution with MCo-op cash loan book growing 329.7% y/y to Kshs 2.2 bn in Q1'2016 from 0.5 bn in Q1'2016 and agency banking transactions growing 118.2% y/y to 6.0 mn from 2.8 mn in Q1'2016. The current revenue mix stands at 66:44 funded to non-funded income
- Operating expenses grew by 21.7% to Kshs 5.2 bn in Q1'2016 from Kshs 4.3 bn in Q1'2015 driven by a 15.5% rise in staff costs and a 78.6% increase in loan loss provision charge. The faster growth in expenses resulted in an increase in cost to income ratio to 51.0% from 49.4% in Q1'2015
- Q1'2016 PAT growth came in slightly higher than our expectations (8.3% growth to Kshs 3.4 bn from Kshs 3.2 bn compared to our projection of an 8.2% growth)

**Balance Sheet**

- The balance sheet recorded a relatively good growth with total liabilities increasing by 13.3% to Kshs 350.7 bn from Kshs 309.6 bn in Q1'2015 compared to our projections of a 17.4% growth supported by a growing customer base currently at excess of 6.0 mn account holders, while shareholders' funds increased by 17.3% to Kshs 55.3 bn
- Customer deposits increased by 11.9% to Kshs 261.7bn from Kshs 233.9 bn in Q1'2015. Loan growth outpaced deposit growth coming at 16.1% to Kshs 213.7 bn from Kshs 184.1 bn in Q1'2015 leading to an increase in the loan to deposit ratio to 81.7% from 78.7% in Q1'2015, slightly higher than the industry average of 89.0%
- Non-performing loans grew by 10.8% to Kshs 8.6 bn from Kshs 7.7 bn in Q1'2015 compared to an increase in gross loans of 16.1% which led to a decrease in NPL ratio to 4.0% from 4.2% in Q1'2015
- The yield on interest earning assets declined to 12.5% from 13.5% in Q1'2016 while the cost of funds declined to 3.5% from 3.7%
- Coop Group Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 15.4%, 4.9% above the statutory requirement

Coop Group management remains positive that;

- i. The branch transformation and channel migration that has seen 85% of the group transactions coming from alternative will continue to optimize costs
- ii. Enhanced credit management systems and process will ensure to quality loan book
- iii. Enhanced data analytics will drive sales by lead generation and improve credit management
- iv. Improved operational efficiencies will drive down operating costs

**Below is a summary of the key line items in the balance sheet and income statement**

**Figures in Kshs billions unless otherwise stated**

Balance Sheet Items	Q1'2015	Q1' 2016	FY'2015	y/y change	FY'2015e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	49.5	39.2	64.9	-20.8%	59.5	51.7%	(72.5%)
Net Loans and Advances	184.1	213.7	208.6	16.1%	224.6	5.1%	11.0%
Total Assets	309.6	350.7	342.5	13.3%	360.9	2.9%	10.4%
Customer Deposits	233.9	261.7	265.4	11.9%	278.7	6.5%	5.4%
Total Liabilities	262.4	295.8	292.7	12.7%	308.1	4.2%	8.6%
Shareholders' Funds	47.2	55.3	50.2	17.3%	53.2	(3.8%)	21.1%

Balance Sheet Ratios	Q1'2015	FY 2015	Q1'2016
Loan to Deposit Ratio	78.7%	78.8%	81.7%
Return on average equity	20.0%	25.0%	16.2%
Return on average assets	3.1%	3.1%	2.5%

Income Statement	Q1'2015	FY 2015	Q1'2016	y/y change	FY'2015e	Projected% y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	5.8	21.3	6.8	16.2%	8.9	30.7%	(14.5%)
Non-Interest Income	2.9	10.8	3.5	20.7%	3.5	1.3%	19.4%
Total Operating income	8.7	32.1	10.3	17.7%	9.4	(8.1%)	25.7%
Loan Loss provision	(0.4)	(1.2)	(0.6)	78.6%	(0.4)	(30.7%)	109.3%
Total Operating expenses	(4.3)	(20.1)	(5.2)	21.7%	(5.2)	(0.8%)	22.6%
Profit before tax	4.5	10.9	4.9	9.7%	4.2	(14.3%)	24.0%
Profit after tax	3.2	8.0	3.4	8.3%	3.4	(2.4%)	10.7%
Earnings per share	0.7		0.8	18.5%	0.7	(11.0%)	29.4%

Income Statement Ratios	Q1'2015	FY 2015	Q1'2016
Yield from interest-earning assets	13.5%	13.8%	12.5%
Cost of funding	3.7%	3.8%	3.5%
Net Interest Spread	9.8%	10.1%	8.9%
Net Interest Income as % of operating income	67.1%	66.3%	66.2%
Non-Funded Income as a % of operating income	32.9%	33.7%	33.8%
Cost to Income	45.3%	59.0%	45.0%

Cost to Assets	1.4%	5.7%	1.5%
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Capital Adequacy Ratios	Q1'15	Q1'16
Core Capital/Total Liabilities	16.70%	17.50%
Minimum Statutory ratio	10.50%	10.50%
<b>Excess</b>	<b>6.20%</b>	<b>7.00%</b>
Core Capital/Total Risk Weighted Assets	14.20%	15.40%
Minimum Statutory ratio	10.50%	10.50%
<b>Excess</b>	<b>3.70%</b>	<b>4.90%</b>
Total Capital/Total Risk Weighted Assets	21.10%	21.70%
Minimum Statutory ratio	14.50%	14.50%
<b>Excess</b>	<b>6.60%</b>	<b>7.20%</b>
Liquidity Ratio	41.10%	39.00%
Minimum Statutory ratio	20.00%	20.00%
<b>Excess</b>	<b>21.10%</b>	<b>19.00%</b>