

Below is a summary of Co-operative Bank of Kenya Ltd FY'2022 performance:

Balance Sheet Items (Kshs bn)	FY'2021	FY'2022	y/y change
Government Securities	184.1	173.3	(5.9%)
Net Loans and Advances	310.2	339.4	9.4%
<b>Total Assets</b>	<b>579.8</b>	<b>607.2</b>	<b>4.7%</b>
Customer Deposits	407.7	423.8	3.9%
Deposits per Branch	2.29	2.34	2.2%
<b>Total Liabilities</b>	<b>479.0</b>	<b>499.3</b>	<b>4.2%</b>
<b>Shareholders' Funds</b>	<b>100.2</b>	<b>107.7</b>	<b>7.4%</b>

Balance Sheet Ratios	FY'2021	FY'2022	y/y change
Loan to Deposit Ratio	76.1%	80.1%	4.0%
Return on average equity	17.3%	21.2%	3.9%
Return on average assets	3.0%	3.7%	0.7%

Income Statement (Kshs bn)	FY'2021	FY'2022	y/y change
Net Interest Income	41.0	45.5	10.9%
Non-Interest Income	19.4	25.7	32.7%
<b>Total Operating income</b>	<b>60.4</b>	<b>71.3</b>	<b>17.9%</b>
Loan Loss provision	(7.9)	(8.7)	9.4%
Total Operating expenses	(38.1)	(42.2)	10.9%
Profit before tax	22.6	29.4	29.9%
<b>Profit after tax</b>	<b>16.5</b>	<b>22.0</b>	<b>33.2%</b>
<b>Earnings per share (Kshs)</b>	<b>2.4</b>	<b>3.2</b>	<b>33.2%</b>

Income Statement Ratios	FY'2021	FY'2022	Y/Y Change
Yield from interest-earning assets	11.5%	12.0%	0.5%
Cost of funding	3.3%	3.5%	0.2%
Net Interest Spread	8.2%	8.5%	0.3%
Net Interest Income as % of Total Income	67.9%	63.9%	(4.0%)
Non-Funded Income as a % of Total Income	32.1%	36.1%	4.0%
Cost to Income	63.0%	59.3%	(3.7%)
Cost to Income Ratio without provisions	49.9%	47.1%	(2.8%)
Cost to Assets	5.2%	5.5%	0.3%
Net Interest Margin	8.5%	8.9%	0.4%

Capital Adequacy Ratios	FY'2021	FY'2022	% points change
Core Capital/Total deposit Liabilities	19.6%	21.9%	2.3%
Minimum Statutory ratio	8.0%	8.0%	
<b>Excess</b>	<b>11.6%</b>	<b>13.9%</b>	<b>2.3%</b>
Core Capital/Total Risk Weighted Assets	15.6%	16.9%	1.3%
Minimum Statutory ratio	10.5%	10.5%	
<b>Excess</b>	<b>5.1%</b>	<b>6.4%</b>	<b>1.3%</b>
Total Capital/Total Risk Weighted Assets	17.2%	18.0%	0.8%
Minimum Statutory ratio	14.5%	14.5%	
<b>Excess</b>	<b>2.7%</b>	<b>3.5%</b>	<b>0.8%</b>
Liquidity Ratio	53.8%	48.3%	(5.5%)
Minimum Statutory ratio	20.0%	20.0%	

Excess	33.8%	28.3%	(5.5%)
Adjusted Core Capital/Total Deposit Liabilities	16.0%	21.9%	5.9%
Adjusted Core Capital/Total Risk Weighted Assets	12.8%	16.9%	4.1%
Adjusted Total Capital/Total Risk Weighted Assets	14.3%	18.0%	3.7%

### Income Statement

- Core earnings per share rose by 33.2% to Kshs 3.2 from Kshs 2.4 in FY'2021, higher than our expectations of a 19.0% increase to Kshs 2.9, with the variance stemming from the 17.9% increase in total operating income, which was higher than our projection of an 11.5% increase. The performance was driven by a 17.9% increase in total operating income to Kshs 71.3 bn in FY'2022, from Kshs 60.4 bn in FY'2021, which outpaced the 10.9% increase in the total operating expenses to Kshs 42.2 bn in FY'2022, from Kshs 38.1 bn in FY'2021,
- Total operating income rose by 17.9% to Kshs 71.3 bn in FY'2022, from Kshs 60.4 bn in FY'2021 mainly driven by a 10.9% increase in Net Interest Income (NII) to Kshs 45.5 bn, from Kshs 41.0 bn in FY'2021 coupled with a 32.7% growth in Non-Funded Income (NFI) to Kshs 25.7 bn, from Kshs 19.4 bn in FY'2021,
- Interest income rose by 11.0% to Kshs 61.7 bn in FY'2022, from Kshs 55.6 bn in FY'2021 driven by a 10.7% increase in interest income from loans and advances to Kshs 40.4 bn, from Kshs 36.5 bn in FY'2021, coupled with an 11.4% increase in interest income from government securities to Kshs 20.9 bn, from Kshs 18.7 bn in FY'2021. The Yield on Interest-Earning Assets increased by 0.5% points to 12.0%, from 11.5% in FY'2021 due to the faster 11.0% growth in the trailing interest income, which outpaced the 5.9% growth in average interest earning assets. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense increased by 11.0% to Kshs 16.2 bn in FY'2022, from Kshs 14.6 bn in FY'2021, largely due to an 8.1% growth in interest expense on customer deposits to Kshs 14.4 bn, from Kshs 13.3 bn in FY'2021 coupled with 26.8% increase in other interest expenses to Kshs 1.4 bn from Kshs 1.1 bn in FY'2021. Cost of funds (COF) increased by 0.2% points to 3.5%, from 3.3% as recorded in FY'2021, owing to the 11.0% increase in trailing interest expense, which outpaced the 5.5% growth in average interest bearing liabilities. On the other hand, Net Interest Margin (NIM) increased by 0.4% points to 8.9% from 8.5% in FY'2021, attributable to the 10.9% growth trailing NII which outpaced the 5.9% growth in average interest-earning assets (NII),
- Non-Funded Income increased by 32.7% to Kshs 25.7 bn in FY'2022, from Kshs 19.4 bn in FY'2021, mainly driven by a 38.7% rise in fees and commissions from loans and advances to Kshs 7.5 bn, from Kshs 5.4 bn in FY'2021. Other fees and commissions also increased by 28.0% to Kshs 12.6 bn from Kshs 9.8 bn in FY'2021. As such, Co-operative Bank's total fees and commissions increased by 32.7% to Kshs 25.7 bn in FY'2022, from Kshs 19.4 bn in FY'2021. Additionally, foreign exchange trading income increased by 65.6% to Kshs 4.7 bn in FY'2022, from Kshs 2.8 bn in FY'2021. As a result, the revenue mix shifted to 64:36 funded to non-funded income, from 68:32 funded to non-funded income in FY'2022, owing to the 32.7% increase in NFI which outpaced the 10.9% growth in NII,
- Total operating expenses increased by 10.9% to Kshs 42.2 bn in FY'2022, from Kshs 38.1 bn in FY'2021, largely driven by an 11.6% increase in other operating expenses to Kshs 18.8 bn, from Kshs 16.8 bn in FY'2021 coupled with an 11.0% increase in staff costs to Kshs 14.8 bn, from Kshs 13.3 bn in FY'2021. Loan Loss Provisions (LLP) increased by 9.4% to Kshs 8.7 bn, from Kshs 7.9 bn in FY'2021. The increased provisioning levels are indicative of the heightened credit risk,
- The Cost to Income Ratio (CIR) improved to 59.3% in FY'2022, from 63.0% in FY'2021 owing to the 17.9% increase in the total operating income which outpaced the 10.9% increase in the total operating expenses. Without LLP, the Cost to Income ratio improved as well to 47.1%, from 49.9% in FY'2021, an indication of improving efficiency levels, and,

- Profit before tax and exceptional items rose by 29.9% to Kshs 29.4 bn, from Kshs 22.6 bn in FY'2021, with the effective tax rate declining to 28.2% in FY'2022, from 31.9% seen in FY'2021. Similarly, the bank recorded a 33.2% increase in profit after tax to Kshs 22.0 bn in FY'2022, from Kshs 16.5 bn in FY'2021.
- Co-operative Bank's directors recommended a first and final dividend per share of Kshs 1.5 in FY'2022 representing a dividend yield of 12.2% as of 17<sup>th</sup> March, 2022. This is a 50.0% increase from the dividend per share of Kshs 1.0 in FY'2021. Additionally, the dividend payout ratio increased to 39.9% in FY'2022, from 35.5% in FY'2021.

### **Balance Sheet**

- The balance sheet recorded an expansion as total assets grew by 4.7% to Kshs 607.2 bn in FY'2022, from Kshs 579.8 bn in FY'2021, mainly attributable to the 9.4% growth in net loans and advances to Kshs 339.4 bn in FY'2022, from Kshs 310.2 bn in FY'2021. On the other hand, government securities declined by 5.9% to Kshs 173.3 bn, from Kshs 184.1 bn recorded in FY'2021, indicating a shift to increased lending as compared to allocation to government securities following the improvement in business environment towards the end of the year,
- Total liabilities grew by 4.2% to Kshs 499.3 bn, from Kshs 479.0 bn in FY'2021, largely attributable to a 3.9% rise in customer deposits to Kshs 423.8 bn in FY'2022, from Kshs 407.7 bn in FY'2021 and a 12.1% growth in borrowings to Kshs 48.1 bn from Kshs 42.9 bn recorded in FY'2021. Deposits per branch increased by 2.2% to Kshs 2.34 bn, from Kshs 2.29 bn in FY'2021, with the number of branches increasing to 181 in FY'2022, from 178 recorded in FY'2021,
- The faster 9.4% growth in net loans and advances compared to the 3.9% growth in deposits, led to an increase in the loan to deposit ratio to 80.1%, from 76.1% in FY'2021,
- Gross Non-Performing Loans (NPLs) increased by 5.2% to Kshs 52.3 bn in FY'2022, from Kshs 49.7 bn in FY'2021 while Gross Loans increased by 9.4% to Kshs 373.5 bn from Kshs 341.3 bn in FY'2021. Consequently, the asset quality improved with the NPL ratio declining to 14.0% in FY'2022, from 14.6% in FY'2021. The improved asset quality is attributable to the continued economic recovery, improved business environment as well as the Group's proactive credit management strategies,
- Provisions increased by 14.6% to Kshs 28.4 bn, from Kshs 24.8 bn in FY'2021. The NPL coverage ratio consequently improved to 65.1% in FY'2022, from 62.6% in FY'2021, due to the faster 14.6% growth in provisions which outpaced the 4.7% increase in Gross Non-Performing Loans (NPLs),
- Shareholders' funds increased by 7.4% to Kshs 107.7 bn in FY'2022, from Kshs 100.2 bn in FY'2021, mainly driven by a 16.0% increase in the retained earnings to Kshs 97.7 bn, from Kshs 84.2 bn in FY'2021,
- Co-operative Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.9%, 6.4% points above the statutory requirement of 10.5%. The total capital to risk-weighted assets ratio came in at 18.0%, exceeding the statutory requirement of 14.5% by 3.5% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 16.9%, while total capital to risk-weighted assets came in at 18.0%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.7%, and a Return on Average Equity (ROaE) of 21.2%.

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

1. **Earnings Growth-** Core earnings per share rose by 33.2% to Kshs 3.2 from Kshs 2.4 in FY'2021, higher than our expectations of a 19.0% increase to Kshs 2.9, with the variance stemming from the 17.9% increase in total operating income, which was higher than our projection of an 11.5% increase. The performance was driven by a 17.9% increase in total operating income to Kshs 71.3 bn in FY'2022, from Kshs 60.4 bn in FY'2021, which outpaced the 10.9% increase in the total operating expenses to Kshs 42.2 bn in FY'2022, from Kshs 38.1 bn in FY'2021,

2. **Increased Lending compared to a decline in Government Security** – The Group's net loans and advances increased by 9.4% to Kshs 339.4 bn in FY'2022, from Kshs 310.2 bn in FY'2021. On the other hand, government securities declined by 5.9% to Kshs 173.3 bn, from Kshs 184.1 bn recorded in FY'2021, indicating a management shift to increased lending as compared to allocation to government securities following the improvement in business environment towards the end of the year,
3. **Improvement in Asset Quality** – The group's asset quality improved, with the NPL ratio reducing to 14.0% in FY'2022, from 14.6% in FY'2021, owing to the 9.4% growth in gross loans to Kshs 373.5 bn, from Kshs 341.3 bn in FY'2021, which outpaced the 5.2% increase in gross non-performing loans. The improved asset quality was attributable to the proactive credit management strategies that have seen increased loan repayments as well as the robust increase in lending, and,
4. **Improved Efficiency** - The group enhanced their efficiency levels evidenced by an improvement in Cost to Income Ratio (CIR) improving to 59.3% in FY'2022, from 63.0% in FY'2021 owing to the 17.9% increase in the total operating income which outpaced the 10.9% increase in the total operating expenses. Without LLP, the Cost to Income ratio improved as well to 47.1%, from 49.9% in FY'2021.

Going forward, we expect the bank's growth to be driven by:

- I. **Diversification through Digitization:** The bank's continued concentration on channel diversification will likely see it continue generating more profit, as they will continue to record increased usage and traffic. The Group's platforms such as MCo-op Cash is offering convenience by offering variety of mobile banking services such as money transfer and payment services. As of Q3'2022, 94.0% of the transactions were done on the alternative channels such as mobile and internet while only 6.0% were via branch. This has increased Non-Funded Income by 32.7% to Kshs 25.7 bn in FY'2022, from Kshs 19.4 bn in FY'2021 and is expected to continue to drive NFI growth and also transform branches to handle advisory, wealth management and advisory services.

#### **Valuation Summary**

- We are of the view that Co-operative Bank is a "BUY" with a target price of Kshs 14.5, representing an upside of 18.0%, from the current price of Kshs 12.3 as of 17<sup>th</sup> March 2023,
- Co-operative Bank is currently trading at a P/TBV of 0.7x and a P/E of 3.5x vs an industry average of 0.8x and 4.0x, respectively.