Co-operative Bank of Kenya Ltd – Q1'2023

19th May, 2023

Below is a summary of Co-operative Bank of Kenya Ltd Q1'2023 performance:

Balance Sheet Items (Kshs bn)	Q1'2022	Q1'2023	y/y change
Government Securities	183.4	179.2	(2.3%)
Net Loans and Advances	324.5	360.1	11.0%
Total Assets	**597.0**	**631.1**	**5.7%**
Customer Deposits	410.8	419.8	2.2%
Deposits per Branch	2.28	2.32	1.6%
Total Liabilities	**493.9**	**518.2**	**4.9%**
Shareholders' Funds	**102.7**	**112.6**	**9.7%**

Balance Sheet Ratios	Q1'2022	Q1'2023	y/y change
Loan to Deposit Ratio	79.0%	85.8%	6.8%
Return on average equity	19.3%	20.7%	1.5%
Return on average assets	3.3%	3.6%	0.3%

Income Statement (Kshs bn)	Q1'2022	Q1'2023	y/y change
Net Interest Income	10.4	10.8	3.9%
Non-Interest Income	6.4	7.1	10.8%
Total Operating income	**16.8**	**17.9**	**6.5%**
Loan Loss provision	(1.5)	(1.5)	(0.7%)
Total Operating expenses	(9.0)	(9.8)	8.8%
Profit before tax	7.8	8.1	4.6%
Profit after tax	**5.8**	**6.1**	**4.7%**
Earnings per share (Kshs)	**0.8**	**0.9**	**4.7%**

Income Statement Ratios	Q1'2022	Q1'2023	Y/Y Change
Yield from interest-earning assets	11.2%	11.7%	0.5%
Cost of funding	3.2%	3.7%	0.4%
Net Interest Spread	7.9%	8.1%	0.1%
Net Interest Income as % of Total Income	61.8%	60.3%	(1.5%)
Non-Funded Income as a % of Total Income	38.2%	39.7%	1.5%
Cost to Income	53.8%	54.9%	1.1%
Cost to Income Ratio without provisions	44.6%	46.3%	1.7%
Cost to Assets	1.25%	1.31%	0.06%
Net Interest Margin	8.3%	8.5%	0.2%

Capital Adequacy Ratios	Q1'2022	Q1'2023	% points change
Core Capital/Total deposit Liabilities	19.8%	22.7%	2.9%
Minimum Statutory ratio	8.0%	8.0%	
Excess	**11.8%**	**14.7%**	**2.9%**
Core Capital/Total Risk Weighted Assets	15.3%	16.3%	1.0%
Minimum Statutory ratio	10.5%	10.5%	
Excess	**4.8%**	**5.8%**	**1.0%**
Total Capital/Total Risk Weighted Assets	16.6%	17.2%	0.6%
Minimum Statutory ratio	14.5%	14.5%	
Excess	**2.1%**	**2.7%**	**0.6%**
Liquidity Ratio	54.1%	50.6%	(3.5%)
Minimum Statutory ratio	20.0%	20.0%	

Excess	**34.1%**	**30.6%**	**(3.5%)**
Adjusted Core Capital/Total Deposit Liabilities	16.0%	22.7%	6.7%
Adjusted Core Capital/Total Risk Weighted Assets	12.3%	16.3%	4.0%
Adjusted Total Capital/Total Risk Weighted Assets	13.6%	17.2%	3.6%

Income Statement

- Core earnings per share rose by 4.7% to Kshs 0.9 from Kshs 0.8 in Q1'2022. The performance was driven by a 6.5% increase in total operating income to Kshs 17.9 bn in Q1'2023, from Kshs 16.8 bn in Q1'2022. The performance was however weighed down by the 8.8% increase in the total operating expenses to Kshs 9.8 bn in Q1'2022, from Kshs 9.0 bn in Q1'2022,
- Total operating income rose by 6.5% to Kshs 17.9 bn in Q1'2023, from Kshs 16.8 bn in Q1'2022 mainly driven by a 10.8% increase in Non-Funded Income (NFI) to Kshs 7.1 bn, from Kshs 6.4 bn in Q1'2022, coupled with a 3.9% growth in Net Interest Income (NII) to Kshs 10.8 bn, from Kshs 10.4 bn in Q1'2022,
- Interest income rose by 11.2% to Kshs 15.6 bn in Q1'2023, from Kshs 14.0 bn in Q1'2022 driven by a 11.6% increase in interest income from loans and advances to Kshs 10.0 bn, from Kshs 9.0 bn in Q1'2022, coupled with a 3.8% interest income from government securities to Kshs 5.1 bn, from Kshs 4.9 bn in Q1'2022. Consequently, the Yield on Interest-Earning Assets increased by 0.5% points to 11.7%, from 11.2% in Q1'2022, due to the faster 12.7% growth in the trailing interest income, which outpaced the 6.9% 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 32.2% to Kshs 4.8 bn in Q1'2023, from Kshs 3.6 bn in Q1'2022, largely due to a 20.5% growth in interest expense on customer deposits to Kshs 3.9 bn, from Kshs 3.3 bn in Q1'2022 coupled with 119.3% increase in other interest expenses to Kshs 0.8 bn from Kshs 0.3 bn in Q1'2022. Consequently, the Cost of funds (COF) increased by 0.5% points to 3.7%, from 3.2% as recorded in Q1'2022, owing to the 18.9% increase in trailing interest expense, which outpaced the 6.4% growth in average interest bearing liabilities. On the other hand, Net Interest Margin (NIM) increased by 0.2% points to 8.5%, from 8.3% in Q1'2022, attributable to the 10.4% growth trailing NII which outpaced the 6.9% growth in average interest-earning assets (NII),
- Non-Funded Income increased by 10.8% to Kshs 7.1 bn in Q1'2023, from Kshs 6.1 bn in Q1'2022, mainly driven by a 30.9% rise in fees and commissions from loans and advances to Kshs 3.4 bn, from Kshs 2.6 bn in Q1'2022, coupled with a 43.8% increase in foreign exchange trading income to Kshs 1.1 bn in Q1'2023, from Kshs 0.8 bn in Q1'2022. As a result, the revenue mix shifted to 60:40 funded to non-funded income, from 62:38 funded to non-funded income in Q1'2022, owing to the 10.8% increase in NFI which outpaced the 3.9% growth in NII,
- Total operating expenses increased by 8.8% to Kshs 9.8 bn in Q1'2023, from Kshs 9.0 bn in Q1'2022, largely driven by an 12.8% increase in staff cost to Kshs 4.0 bn, from Kshs 3.5 bn in Q1'2022 coupled with an 8.9% increase in other operating costs to Kshs 4.3 bn, from Kshs 4.0 bn in Q1'2022. However, Loan Loss Provisions (LLP) decreased by 0.5 % to Kshs 1.53 bn, from Kshs 1.54 bn in Q1'2022, an indication of reduced provisioning,
- The Cost to Income Ratio (CIR) deteriorated to 54.9% in Q1'2023, from 53.8% in Q1'2022 owing to the 8.8% increase in the total operating expenses which outpaced the 6.5% increase in the total operating income. Without LLP, the Cost to Income ratio deteriorated as well to 46.3%, from 44.6% in Q1'2022, an indication of declined efficiency levels, and,
- Profit before tax and exceptional items rose by 4.6% to Kshs 8.1 bn, from Kshs 7.8 bn in Q1'2022, with the effective tax rate remaining unchanged at 29.0% as was recorded in Q1'2022. Similarly, the bank recorded a 4.7% increase in profit after tax to Kshs 6.1 bn in Q1'2023, from Kshs 5.8 bn in Q1'2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 5.7% to Kshs 631.1 bn in Q1’2023, from Kshs 597.0 bn in Q1’2022, mainly attributable to the 11.0% growth in net loans and advances to Kshs 360.1 bn in Q1’2023, from Kshs 324.5 bn in Q1’2022. However, the expansion was weighed down a 2.3% decline in government securities to Kshs 179.2 bn, from Kshs 183.4 bn recorded in Q1’2022, an indication of a shift to increased lending as compared to allocation towards government securities,
- Total liabilities grew by 4.9% to Kshs 518.2 bn, from Kshs 493.9 bn in Q1’2022, largely attributable to a 2.2% rise in customer deposits to Kshs 419.8 bn in Q1’2023, from Kshs 410.8 bn in Q1’2022 and a 11.8% growth in borrowings to Kshs 48.4 bn from Kshs 43.3 bn recorded in Q1’2022. Deposits per branch increased by 1.6% to Kshs 2.32 bn, from Kshs 2.28 bn in Q1’2022, with the number of branches increasing to 181 in Q1’2023, from 180 recorded in Q1’2022,
- The faster 11.0% growth in net loans and advances compared to the 2.2% growth in deposits, led to an increase in the loan to deposit ratio to 85.8%, from 79.0% in Q1’2022,
- Gross Non-Performing Loans (NPLs) increased by 12.6% to Kshs 55.7 bn in Q1’2023, from Kshs 49.5 bn in Q1’2022 while Gross Loans increased by 10.6% to Kshs 394.7 bn from Kshs 356.8 bn in Q1’2022. Consequently, the asset quality deteriorated with the NPL ratio increasing to 14.1% in Q1’2023, from 13.9% in Q1’2022, partly attributable to the tough economic environment occasioned the elevated inflationary pressures,
- On the other hand, the NPL coverage decreased to 62.2% in Q1’2023, from 65.3% in Q1’2022, owing to the 12.6% growth in Gross Non-Performing Loans (NPLs) which outpaced the 8.9% increase in provisions,
- Shareholders’ funds increased by 9.7% to Kshs 112.6 bn in Q1’2023, from Kshs 102.7 bn in Q1’2022, mainly driven by a 15.2% increase in the retained earnings to Kshs 103.8 bn, from Kshs 90.1 bn in Q1’2022,
- Co-operative Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.3%, 5.8% points above the statutory requirement of 10.5%. The total capital to risk-weighted assets ratio came in at 17.2%, exceeding the statutory requirement of 14.5% by 2.7% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 16.3%, while total capital to risk-weighted assets came in at 17.2%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.6%, and a Return on Average Equity (ROaE) of 20.7%.

Key Take-Outs:

1. **Earnings Growth-** Core earnings per share rose by 4.7% to Kshs 0.9 from Kshs 0.8 in Q1’2022. The performance was driven by a 6.5% increase in total operating income to Kshs 17.9 bn in Q1’2023, from Kshs 16.8 bn in Q1’2022. The performance was however weighed down by the 8.8% increase in the total operating expenses to Kshs 9.8 bn in Q1’2022, from Kshs 9.0 bn in Q1’2022,
2. **Increased Lending**– The Group’s net loans and advances increased by 11.0% to Kshs 360.1 bn in Q1’2023, from Kshs 324.5 bn in Q1’2022, highlighting the Bank’s aggressive lending despite the tough operating business environment. On the other hand, government securities declined by 2.3% to Kshs 179.2 bn, from Kshs 183.4 bn recorded in Q1’2022, indicating a continued diversification of their exposure aimed at cushioning the bank against any potential risk,
3. **Decline in Efficiency Levels** - The Bank’s efficiency levels have declined evidenced by a deterioration in Cost to Income Ratio (CIR) to 54.9% in Q1’2023, from 53.8% in Q1’2022 owing to the 8.8% increase in the total operating expenses which outpaced the 6.5% increase in the total operating income. Similarly, Without LLP, the Cost to Income ratio increased to 46.3%, from 44.6% in Q1’2022,and,

4. **Deterioration in Asset Quality** – The group’s asset quality deteriorated, with the NPL ratio increasing to 14.1% in Q1’2023, from 13.9% in Q1’2022, owing to the 12.6% growth in gross non-performing loans to Kshs 394.7 bn, from Kshs 356.8 bn in Q1’2022, which outpaced the 10.6% increase in Gross loans.

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 FY’2022, 92.0% of the transactions were done on the alternative channels such as mobile and internet while only 8.0% were via branch. This has increased Non-Funded Income by 10.8% to Kshs 7.1 bn in Q1’2023, from Kshs 6.4 bn in Q1’2022 and is expected to continue to drive NFI growth and also transform braches 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 15.9, representing an upside of 42.0%, from the current price of Kshs 12.0 as of 19th May 2023, inclusive of a dividend yield of 12.2%.
- Co-operative Bank is currently trading at a P/TBV of 0.6x and a P/E of 3.5x vs an industry average of 0.7x and 3.4x, respectively.