



**Co-operative
Bank FY'23
Earnings Note**





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March 28th, 2024

Ticker Information

NSE Code:	COOP
Issued Shares (Bn):	5.87
52-week high:	KES 14.70
52-week low:	KES 10.20

Chart 1: Price Trend (Last 12 Months)



Source: NSE, AIB-AXYS Research

Historical Share Performance

Last	1M	3M	6M	12M
Change	15.8%	34.4%	27.0%	19.9%

Source: NSE, AIB-AXYS Research

Analysts

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Recommendation

HOLD

Current Price

KES 15.05

Target Price

KES 16.55

Summary

- **Co-operative Bank of Kenya recorded lower-than-expected performance to post a mild 5.2% y/y growth in net earnings to KES 23.19Bn throughout 2023.** Net interest incomes declined marginally by 60bps y/y – grounded by a faster surge in interest expenses relative to interest incomes. Net interest margin contracted 90bps to 7.6% due to higher funding costs associated with mobilizing corporate deposits.
- **The Board of Directors recommend a first and final Dividend of KES 1.50 per share.** This distribution fell below our lower bound expectation of a total dividend of KES 1.75, translating to a dividend payout ratio of 38.0%. The dividend will be payable on 10th June 2024 to shareholders on register as of 28th April 2024.

Key Highlights

- **Lackluster Core Performance:** Net Interest Income contracted 0.6% y/y to KES 45.23Bn while non-interest income saw a modest 2.8% y/y increase to KES 26.46Bn consequently leading to a 0.6% y/y increase in operating income. Yield on interest earnings assets increased 40bps y/y to 12.4% - pointing to effective reinvestment returns in the year. The cost of funds increased 130bps y/y to 4.8% in tandem with the rising interest rate landscape. Consequently, net interest margin contracted 90bps y/y to 7.6% - reflecting the challenging operating environment.
- **Asset Quality Resilience:** Gross Non-Performing Loans (NPLs) increased 27.9% to KES 66.94Bn driven largely by increased credit deterioration in the real estate, trade, transport, and energy sectors. This drove a 220bps y/y increase in the Gross NPL ratio to 16.4%. Despite this uptrend in delinquencies, management elected to free up credit impairment provisions by 30.8% y/y – signaling the lender's confidence in its credit portfolio performance over coming quarters.

Balance Sheet Dynamics

Customer deposits grew 6.6% y/y to KES 451.64Bn driven by an acceleration in corporate customer deposits. Customer Loans and advances grew 10.3% y/y to KES 374.23Bn driven by increased digital lending to both Retail and Corporate segments. Consequently, the loan deposit ratio increased by 571bps y/y to 85.8%. Capitalizing on the attractive yields, management strategically increased its allocation to government securities by 9.1% y/y to KES 189.05Bn. However, fair value losses from government securities marginally decreased by 2.8% y/y to KES 8.36Bn – reflecting the bank's proactive management of its investment portfolio amid market fluctuations.

Moderating Efficiency:

The Cost-to-Income ratio (excluding loan-loss provisions) declined marginally by 10bps y/y to 47.0%. This improvement was driven by a 0.6% y/y increase in operating income to KES 71.69Bn – which partially offset the 0.3% y/y decrease in operating expenses to KES 39.67Bn. The Group recorded a sharp 78.8% y/y decline in deferred tax credit, leading to a smaller rise in net earnings. The upshot of this was a mild 20bps decline in the Return on Average Equity to 21.0%.

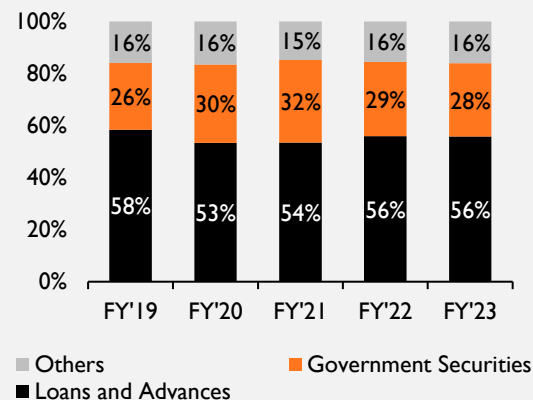
Outlook:

We anticipate the lender's growth will be fueled by increased adoption and utilization of e-banking channels and effective cost containment measures. We expect the vast scope for MSME working capital lending to unlock increasing returns to scale. We also anticipate the bank's long-term growth prospects to be bolstered by the balanced growth across both banking and non-banking subsidiaries. We expect organic growth of the loan portfolio and mild loan repricing will support a steady growth in interest incomes.

Recommendation

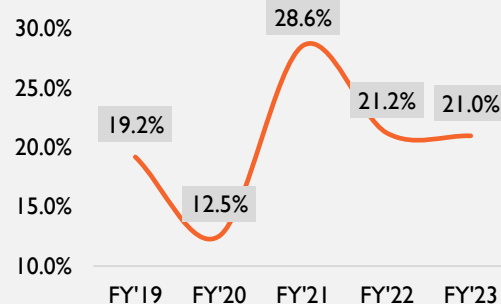
- **We revise our recommendation on Co-operative Bank to HOLD on account of its fast-rising cost of funds and asset quality pressures.** At the current market price, the stock is trading at P/E ratio of 3.8x and a P/B ratio of 0.8x. Our one-year target price for Co-operative Bank of Kenya currently stands at KES 16.55 - representing a c.10.0% upside potential from current levels.

Chart 2: Consistent Asset Composition



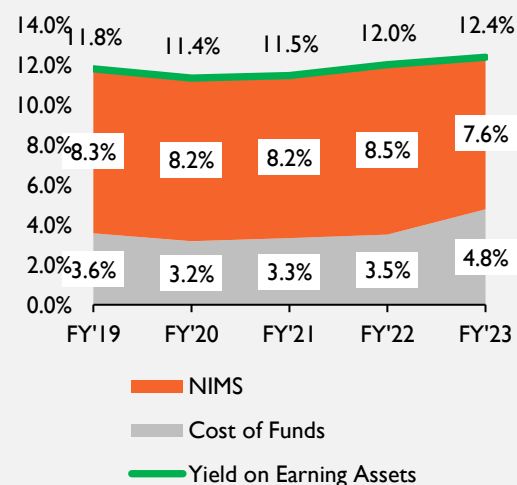
Source: Company filings, AIB-AXYS Research.

Chart 3: Return on Equity Trend



Source: Company filings, AIB-AXYS Research.

Chart 4: Widening Net Interest Margin



Source: Company filings, AIB-AXYS Research.

Income Statement (KES Bn)	FY'19	FY'20	FY'21	FY'22	FY'23	% y/y change
Net Interest Income	31.30	36.35	41.04	45.52	45.23	▼ (0.6%)
Net non-Interest Income	17.16	17.48	19.40	25.73	26.46	▲ 2.8%
Total Operating income	48.46	53.83	60.43	71.25	71.69	▲ 0.6%
Provision for Impairment	(2.54)	(8.11)	(7.93)	(8.68)	(6.01)	▼ (30.8%)
Total Operating expenses	(27.79)	(39.40)	(38.09)	(42.24)	(39.67)	▼ (6.1%)
Profit before tax	20.71	14.28	22.65	29.43	32.36	▲ 10.0%
Profit after tax	14.31	10.81	16.54	22.04	23.19	▲ 5.2%
Annualized EPS	2.44	1.84	2.82	3.76	3.95	▲ 5.2%
DPS	1.00	1.00	1.00	1.50	1.50	-

Balance Sheet (KES Bn)	FY'19	FY'20	FY'21	FY'22	FY'23	% y/y change
Government Securities	117.80	161.89	184.06	173.28	189.05	▲ 9.1%
Loans and Advances	266.71	286.63	310.20	339.39	374.23	▲ 10.3%
Total Assets	457.01	536.95	579.77	607.20	671.13	▲ 10.5%
Customer Deposits	332.82	378.63	407.73	423.80	451.64	▲ 6.6%
Total Liabilities	376.15	444.90	479.03	499.25	557.45	▲ 11.7%
Shareholder's Funds	79.34	90.73	100.22	107.68	113.56	▲ 5.5%

Ratio Analysis	FY'19	FY'20	FY'21	FY'22	FY'23	% y/y change
Spreads Analysis						
Yield on Assets	11.8%	11.4%	11.5%	12.0%	12.4%	▲ 0.4%
Cost of Funds	3.6%	3.2%	3.3%	3.5%	4.8%	▲ 1.3%
Net Interest Margin	8.3%	8.2%	8.2%	8.5%	7.6%	▼ (0.9%)
ROaE	19.2%	12.5%	28.6%	21.2%	21.0%	▼ (0.2%)
ROaA	3.3%	2.1%	4.9%	3.7%	3.6%	▼ (0.1%)
Profit Margin	29.5%	20.1%	27.4%	30.9%	32.3%	▲ 1.4%
Operating Efficiency						
Cost to Income Less LLP	52.1%	58.1%	49.9%	47.1%	47.0%	▼ (0.1%)
Cost to Assets Less LLP	5.5%	5.8%	5.2%	5.5%	5.0%	▼ (0.5%)
Loan to Deposit Ratio	80.1%	75.7%	76.1%	80.1%	82.9%	▲ 2.8%
Asset Quality						
NPL	11.4%	19.1%	14.8%	14.2%	16.4%	▲ 2.2%
NPL Coverage	51.8%	50.3%	62.6%	65.1%	57.2%	▼ (8.0%)
Cost of Risk	5.2%	15.1%	13.1%	12.2%	8.4%	▼ (3.8%)
Capital Adequacy						
Core Capital/TRWA	16.3%	15.4%	15.6%	16.9%	18.2%	▲ 1.3%
Total Capital /TRWA	16.8%	16.9%	17.2%	18.0%	22.5%	▲ 4.5%
Liquidity	46.2%	52.2%	53.8%	48.3%	52.0%	▲ 3.7%



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