



### COOPERATIVE BANK GROUP: 1H18 EARNINGS UPDATE

Dear All,

COOPERATIVE BANK GROUP (CO-OP) released its 1H18 results recording a **7.6% y-o-y growth in profit after tax (PAT) to KES 7.1 BN**. EPS for the period stood at KES 1.22. Trailing EPS stands at KES 2.08 up 8.2% y-o-y. Its ROE rose 11 bps y-o-y to 20.8% whereas its ROA rose 12 bps y-o-y to 3.6%.

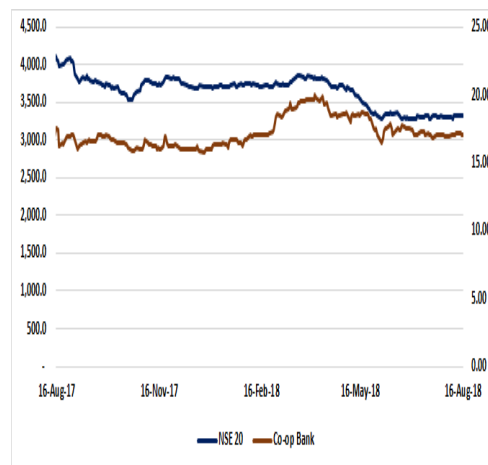
Below please find key highlights:

**Net interest income rose 10.4% y-o-y to KES 14.8 BN** on the back of a 7.9% y-o-y increase in interest income to KES 20.8 BN and a 2.2% y-o-y increase in interest expense to KES 6.0 BN. Annualized cost of funds held fairly flat at 3.7% whereas annualized yield on interest earning assets rose 56 bps y-o-y to 12.0%. Consequently, annualized net interest margin rose 57 bps y-o-y to 8.3%.

**Interest income from loans and advances rose 3.3% y-o-y to KES 16.1 BN** implying an annualized yield on average loans of 12.8% relative to the maximum lending rate of 13.5%-14.0% over the period. Interest income from government securities also rose 17.5% y-o-y to KES 4.5 BN implying an annualized yield on average government securities held of 11.6% above the average 182-day treasury bill yield of about 10.0% over the period. Interest expense from customer deposits rose 2.9% y-o-y to KES 5.4 BN implying an annualized cost of average deposits of 3.7% relative to the minimum floor of 6.5 to 7.0% over the period.

**Non-interest income declined 1.6% y-o-y to KES 7.0 BN**. This followed a 1.7% y-o-y decline in forex income to KES 1.2 BN and a 2.6% y-o-y decline in fees and commissions to KES 5.1 BN that comprised a 41.4% y-o-y decline in fees and commissions on loans to KES 802.72 MN and an 11.0% y-o-y increase in other fees and commissions to KES 4.3 BN. As a result, funded income reliance ratio rose 255 bps y-o-y to 67.9%.

#### COOP GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE RETURN	ABSOLUTE RETURN	EXCESS RETURN
3 month (%)	-8.8	-4.3
6 month (%)	-0.3	9.9
12 month (%)	-2.8	15.2

#### KEY METRICS

Current Price (KES)	17.05
52 week Range (KES)	15.80-19.95
YTD Return (%)	6.6
Issued Shares (MN)	5,867.2
Market Cap (USD BN)	992.7

Recommendation	HOLD
Trailing EPS (KES)	2.08
NAV (KES)	11.59
P/E (x)	8.2
P/B (x)	1.5
Div. Yld (%)	-

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**Operating expenses (less loan loss provisions) rose 10.6% y-o-y to KES 10.9 BN.** This was mainly due to a 13.0% y-o-y rise in staff costs to KES 5.3 BN that followed from continued investment in specialized staff and a 10.2% y-o-y rise in other operating expenses to KES 3.5 BN that followed from investment in systems. The group's cost to income ratio rose 196 bps y-o-y to 49.9% but below the peak of 59.0% in FY14 when the transformation project began.

**Total assets rose 3.9% y-o-y to KES 398.4 BN ( up 0.2% q-o-q).** Loans and advances declined 0.6% y-o-y to KES 251.1 BN whereas investment securities rose 12.0% y-o-y to KES 83.1 BN. MCo-op cash (the bank's mobile solution) continued to grow with a cumulative loan book of KES 15.2 BN as at 1H18 up from KES 12.9 BN at 1Q18.

**Customer deposits grew 3.9% y-o-y to KES 296.9 BN (+0.4% q-o-q)** whereas borrowed funds declined 24.3% y-o-y to KES 18.4 BN. The bank already secured a USD 150.0 MN 7 year senior loan from IFC for onward lending to micro, small and medium enterprises. The first USD 75.0 MN was drawn in June 2018 while the second will be drawn in 1Q19. Loans to deposits ratio declined 384 bps y-o-y to 84.6% whereas loans to deposits and borrowed funds ratio declined 227 bps y-o-y to 78.8%.

**The group's South Sudan's subsidiary made a profit before tax of KES 114.6 MN** compared to a loss of KES 60,000 in 1H17. The group is currently operating 4 branches in Juba-the capital of South Sudan and 5 non-oil collection centers. It also owns 31.0% of CIC South Sudan. We are cautiously optimistic that the new peace agreement between warring factions in South Sudan will take hold. In the event that it does, Co-op's unique partnership with the government presents a key lever that can help them build and maintain market share.

**Co-op Bank Kenya's core capital ratio (Core capital/TRWA) declined 10 bps y-o-y to 15.7% whereas Total capital/TRWA declined 690 bps y-o-y to 15.8%.** Both ratios remain above the statutory minimum of 10.5% and 14.5% respectively. Liquidity ratio rose 220 bps y-o-y to 36.9% (above the statutory minimum of 20.0%). The decline on total capital is attributable to the day one impact of IFRS 9 implementation of about KES 4.4 BN and a declassification of about KES 21.0 BN of debt from total capital following the regulator's guidance that qualifying capital should have at least a 5 year moratorium on both principal and interest.

**Gross non-performing loans (Gross NPLs) rose 130.8% y-o-y to KES 28.2 BN** whereas interest in suspense declined 11.3% y-o-y to KES 0.8 BN. Consequently, total non-performing loans rose 143.1% y-o-y to 27.4 BN. The NPL ratio rose 549 bps y-o-y to 10.1% (flat q-o-q).

**The NPL coverage ratio (Loan loss provision/ Total NPL)** declined 1,109 bps y-o-y to 28.8%. The group has seen a big shift of its loans into both the substandard and doubtful segments courtesy of adoption of IFRS 9 at the beginning of FY18. However, the book remained relatively unchanged in 2Q18 in part due to slowed lending. Generally, we think that risks to asset quality include the on-going demolition exercise and the continued delay of government related payments. Management however clarified that they so far do not have clients exposed to these risks.

<b>KES BN</b>	<b>1H18</b>	<b>1H17</b>	<b>Y-Y% CH</b>	<b>1Q18</b>	<b>Q-Q% CH</b>
Normal	208.2	214.0	(2.7)	208.8	(0.3)
Watch	28.4	34.1	(16.7)	29.3	(3.1)
Substandard	14.8	7.9	87.3	15	(1.3)
Doubtful	12.9	3.6	258.3	12.7	1.6
Loss	0.6	0.7	(14.3)	0.6	0.0

*Source: Company*

**Shareholding in Kenya Mortgage Refinance Company (KMRC):** The Board of Directors has approved KES 200.0 MN capital injection of the share capital of KMRC. KMRC is an initiative of the national government that is aimed at sourcing long term financing to fund the provision of affordable housing under the Big Four agenda.

**FY18 Guidance:** Management reviewed its guidance as follows: 12.0% y-o-y growth in profit before tax (down 300 bps), 5.0% y-o-y growth in loans (down 500 bps), 10.0% y-o-y growth in deposits (down 500 bps), cost of risk of 1.2% (down 200 bps), cost to income ratio of 50.0% (up 200 bps). ROaE, ROaA, NPL, cost of funds and Net Interest Margin targets remain unchanged at 22.0%, 3.8%, 8.0%, 4.0% and 9.0% respectively. The table on the side bar shows how the projections compare to the 1H18 performance.

**On a trailing basis,** Coop Bank Group is trading at a P/E ratio of 8.2x, relative to an industry median of 8.7x, a P/B of 1.5x, relative to an industry median of 1.1x, an ROE of 20.8%, relative to an industry median of 14.5% and an ROA of 3.6%, relative to an industry median of 2.6%. We maintain our **HOLD** recommendation on account of the above median returns.

	<b>1H18</b>	<b>FY18F</b>
PBT(%)	7.6	12.0
Loans(%)	-0.6	5.0
Deposits(%)	4.5	10.0
CTI (%)	49.9	50.0
NFI to TI (%)	32.1	35.0
ROaE (%)	21.6	22.0
ROaA (%)	3.7	3.8
NPLs (%)	10.9	8.0
Cost of funds (%)	3.8	4.0
NIM (%)	9.0	9.0
Cost of risk (%)	0.9	1.2

*Source: Company*

## PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	1H18	1H17	y-y% ch	2q18	1q18	2q17	y-y% ch	q-q% ch
Interest income	20,780	19,258	7.9	10,396	10,384	9,740	6.7	0.1
Interest expense	5,966	5,840	2.2	2,992	2,974	3,008	(0.6)	0.6
Net interest income	14,814	13,418	10.4	7,404	7,410	6,732	10.0	(0.1)
Other operating income	649	600	8.2	444	204	343	29.7	117.4
Fees and commission income	5,124	5,263	(2.6)	2,565	2,559	2,692	(4.7)	0.3
Net income from forex dealings	1,222	1,244	(1.7)	470	753	683	(31.3)	(37.6)
Total non-interest income	6,995	7,106	(1.6)	3,479	3,516	3,718	(6.4)	(1.0)
Total income	21,809	20,524	6.3	10,884	10,925	10,449	4.2	(0.4)
Less operating expenses	10,881	9,838	10.6	5,546	5,335	5,012	10.7	3.9
Operating profit	10,928	10,686	2.3	5,338	5,590	5,438	(1.8)	(4.5)
Bad debt charge	1,093	1,509	(27.6)	330	763	759	(56.5)	(56.7)
Exceptional items	141	92	53.1	70	71	81	(12.8)	(0.8)
Profit before income tax	9,976	9,269	7.6	5,078	4,898	4,759	6.7	3.7
Less tax	2,836	2,632	7.7	1,386	1,450	1,350	2.7	(4.4)
Profit after tax	7,140	6,637	7.6	3,692	3,448	3,410	8.3	7.1
Attributable Income	7,140	6,637	7.6	3,692	3,448	3,410	8.3	7.1
EPS (KES)	1.22	1.13	7.6	0.63	0.59	0.47	33.6	7.1

(Source: Company, DBIB Research)

## BALANCE SHEET SUMMARY (KES MN)

Year End: December	1H18	1Q18	1H17	y-y% ch	q-q% ch
Total shareholder's equity	68,018	67,947	64,478	5.5	0.1
Minority interest	770	742	(197)	(491.6)	3.7
Total Equity	68,788	68,689	64,281	7.0	0.1
Deposits due to other banks	3,194	4,047	1,408	126.9	(21.1)
Customer deposits	296,965	295,884	285,753	3.9	0.4
Borrowed funds	18,426	20,654	24,341	(24.3)	(10.8)
Other liabilities	11,055	8,520	7,543	46.6	29.8
Total equity and liabilities	398,427	397,793	383,326	3.9	0.2
Central bank balances	23,223	23,149	21,795	6.6	0.3
Deposits due from banks	13,453	16,024	11,286	19.2	(16.0)
Investment securities	83,129	78,077	74,200	12.0	6.5
Held for dealing securities	-	-	-	-	-
Customer loans and advances	251,110	252,825	252,613	(0.6)	(0.7)
Other assets	19,228	19,302	13,961	37.7	(0.4)
Intangible assets	1,324	1,277	1,167	13.4	3.6
Fixed assets	6,960	7,138	8,305	(16.2)	(2.5)
Total assets	398,427	397,793	383,326	3.9	0.2

(Source: Company, DBIB Research)

## INVESTMENT RETURN

	1H18	1Q18	1H17	y-y bps ch	q-q bps ch
ROA (%)*	3.6	3.5	3.5	12	12
ROIC (%)*	3.7	3.6	3.5	18	14
ROE (%)*	20.8	20.1	20.7	11	68

(Source: Company, DBIB Research)

\*Annualized

## CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	1H18	1Q18	1H17	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	15.7	16.0	15.8	(10)	(30)
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	15.8	16.1	22.7	(690)	(30)
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	36.9	38.4	34.7	220	(150)
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-
Leverage Ratio (%)	17.1	17.1	16.8	25	(1)
Equity-to-Loans Ratio (%)	27.4	27.2	25.4	195	22
NPL Ratio (%)**	10.1	10.1	4.6	549	1
NPL Coverage Ratio (%) **	28.8	28.7	39.9	(1,109)	17
Long Term Debt to Total Liabilities and Equity (%)	4.6	5.2	6.3	(173)	(57)
NTA/share (KES)	11.4	11.4	12.9	(158)	0
Book value/share (KES)	11.6	11.6	13.2	(159)	1

(Source: Company, DBIB Research)

\*\*Total Loan Portfolio net of Interbank Lending

## OPERATING PERFORMANCE

	1H18	1Q18	1H17	y-y bps ch	q-q bps ch
Yield on interest earning assets (%) *	12.0	12.0	11.4	56	(2)
Cost of funds (%)*	3.7	3.7	3.7	(0)	3
Net Interest Margin (%)*	8.2	8.3	7.6	57	(5)
Loan-to-Deposits ratio (%)	84.6	85.4	88.4	(384)	(89)
Loan-to-Dep.& Borrowed Funds ratio (%)	78.8	78.9	81.1	(227)	(4)
Funded Income Generating Potential (%)	87.3	87.2	88.2	(94)	5
Funded Income Reliance (%)	67.9	67.8	65.4	255	11
Cost to income ratio (%)	49.9	48.8	47.9	196	106
Pre-tax margin (%)	45.7	44.8	45.2	58	91
PAT margin (%)	32.7	31.6	32.3	40	118

(Source: Company, DBIB Research)

\* Annualized

## APPENDIX

### COMPANY INVESTMENT RATINGS

**Buy:** Share price may generate more than 15.0% upside over the next 12 months

**Overweight:** Share price may generate between 5.0% and 15.0% upside over the next 12 months

**Hold:** Share price may fall within the range of <+5.0/ -10.0% over the next 12 months

**Take Profit:** Target price has been attained. Look to accumulate at lower levels. Company fundamentals however remain strong

**Underweight:** Share price may generate between 10.0% and 15.0% downside over the next 12 months

**Sell:** Share price may generate more than 15.0% downside over the next 12 months, significant business and/or financial risks present, industry concerns

**Not Rated:** Counter is not within regular research coverage

### SECTOR INVESTMENT RATINGS

**Overweight:** Industry performance better than that of the whole market

**Equal weight:** Industry performance about the same as that of the whole market

**Underweight:** Industry performance worse than that of the whole market

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