

DYER & BLAIR INVESTMENT BANK

EARNINGS UPDATE

Founder Member of the Nairobi Securities Exchange

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DYER & BLAIR
INVESTMENT BANK

WE KNOW. YOU KNOW.

COOPERATIVE BANK GROUP: 3Q18 EARNINGS UPDATE

Dear All,

COOPERATIVE BANK GROUP (CO-OP) released its 3Q18 results recording an 8.2% y-o-y growth in profit after tax (PAT) to KES 10.3 BN. EPS for the period stood at KES 1.76. Trailing EPS stands at KES 2.12 up 2.0% y-o-y. Its annualized ROE rose 25 bps y-o-y to 19.2% whereas its annualized ROA rose 13 bps y-o-y to 3.4%.

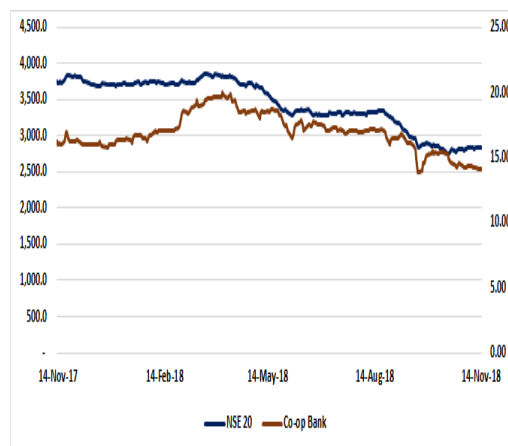
Below please find key highlights:

Net interest income rose 4.7% y-o-y to KES 21.7 BN on the back of a 3.5% y-o-y increase in interest income to KES 30.9 BN and a 0.7% y-o-y increase in interest expense to KES 9.1 BN. Annualized cost of funds declined 4 bps y-o-y to 3.8% whereas annualized yield on interest earning assets declined 6 bps y-o-y to 11.6%. Consequently, annualized net interest margin marginally declined 3 bps y-o-y to 7.8%.

Interest income from loans and advances was fairly flat at KES 23.8 BN (+0.8% y-o-y) implying an annualized yield on average loans of 12.3% relative to the maximum lending rate of 13.0% to 13.5% over the period. Interest income from government securities rose 13.5% y-o-y to KES 6.9 BN. This implied an annualized yield on average government securities of 11.8%. Interest expense from customer deposits was also fairly flat at KES 8.1 BN (+0.4% y-o-y) implying an annualized cost of average deposits of 3.7%.

Non-interest income rose 4.3% y-o-y to KES 10.6 BN. This followed a 13.6% y-o-y rise in forex income to KES 1.8 BN and a 24.1% y-o-y rise in other operating income to KES 0.9 BN. Fees and commissions rose 0.6% y-o-y to KES 7.9 BN comprising a 9.9% y-o-y rise in other fees and commissions to KES 6.6 BN and a 29.7% y-o-y decline in fees on loans and advances to KES 1.3 BN. Funded income reliance rose 8 bps y-o-y to 67.3%.

COOP GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE RETURN	ABSOLUTE RETURN	EXCESS RETURN
3 month (%)	(17.6)	(2.5)
6 month (%)	(24.9)	(5.9)
12 month (%)	(12.2)	11.7

KEY METRICS

Current Price (KES)	14.05
52 week Range (KES)	13.85-19.95
YTD Return (%)	(12.2)
Issued Shares (MN)	5,867.2
Market Cap (USD BN)	803.0

Recommendation	BUY
Target Price	16.14
Trailing EPS (KES)	2.12
NAV (KES)	12.08
P/E (x)	6.6
P/B (x)	1.2
Div. Yield (%)	-

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Operating expenses (less loan loss provisions) rose 12.4% y-o-y to KES 16.5 BN.

This was mainly due to a 12.3% y-o-y rise in staff costs to KES 8.1 BN that followed from continued investment in specialized staff and an 18.6% y-o-y rise in other operating expenses to KES 5.4 BN that followed from investment in systems. The group's cost to income ratio rose 357 bps y-o-y to 51.2% below the peak of 59.0% in FY14 when the transformation project began.

Total assets rose 4.1% y-o-y to KES 404.2 BN (up 1.4% q-o-q). Loans and advances declined 2.0% y-o-y to KES 254.2 BN whereas investment securities rose 20.5% y-o-y to KES 85.8 BN. MCo-op cash (the bank's mobile solution) continued to grow with a cumulative loan book of KES 17.8 BN as at 3Q18.

Customer deposits grew 2.5% y-o-y to KES 296.1 BN (down 0.3% q-o-q) whereas borrowed funds declined 7.2% y-o-y to KES 26.0 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 September 2018 while the second will be drawn in FY19. Loans to deposits ratio declined 391 bps y-o-y to 85.9% whereas loans to deposits and borrowed funds ratio declined 29 bps y-o-y to 78.6%.

The group's South Sudan's subsidiary made a profit before tax of KES 235.1 MN compared to a profit of KES 39.2 MN in 3Q17. 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) rose 70 bps y-o-y to 16.3% whereas Total capital/TRWA declined 600 bps y-o-y to 16.3%. Both ratios remain above the statutory minimum of 10.5% and 14.5% respectively. IFRS9 adjusted core and total ratios stood at 17.1% and 17.2% indicating that the IFRS 9 related impact is about 90 bps. Co-op Bank Kenya's Liquidity ratio rose 650 bps y-o-y to 40.7% (above the statutory minimum of 20.0%). The decline in total capital is attributable to the 1Q18's 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 75.3% y-o-y to KES 29.7 BN whereas interest in suspense also rose 11.2% y-o-y to KES 0.99 BN. Consequently, total non-performing loans rose 78.8% y-o-y to KES 28.7 BN. The NPL ratio rose 433 bps y-o-y to 10.5% (+ 35 bps q-o-q).

The NPL coverage ratio (Loan loss provision/ Total NPL) declined 9 bps y-o-y to 34.6%. The table below shows the group's level of provisioning as at 3Q18 and in relation to 3Q17 and FY17.

KES MN	3Q18	3Q17	FY17
Provision for specific Bad & D Debts	9,799.8	5,559.90	6,075.83
Provision for Interest on Bad & D Debts	998.2	897.37	948.48
General provision for Bad & D Debts	5,050.0	3,134.54	3,166.83
Total	15,848.0	9,591.8	10,191.1

Source: Company

FY18 Guidance: Management reviewed its guidance as follows: 10.0% y-o-y growth in profit before tax (down 200 bps), 0% y-o-y growth in loans (down 500 bps), 5.0% y-o-y growth in deposits (down 500 bps), cost of risk of 1.0% (up 200 bps), cost to income ratio of 50.0%, NPL ratio at 9.0% (up 100 bps) and net interest margin at 8.5% (down 500 bps). ROaE, ROaA, and cost of funds targets remain unchanged at 22.0%, 3.8%, and 4.0% respectively.

On a trailing basis, Coop Bank Group is trading at a P/E ratio of 6.6x, relative to an industry median of 6.2x, a P/B of 1.2x, relative to an industry median of 0.86x, an ROE of 19.2%, relative to an industry median of 17.1% and an ROA of 3.4%, relative to an industry median of 2.3%. We maintain our **BUY** recommendation.

PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	3Q18	3Q17	y-y% ch	3q18	2q18	3q17	y-y% ch	q-q% ch
Interest income	30,892	29,853	3.5	10,112	10,396	10,595	(4.6)	(2.7)
Interest expense	9,148	9,084	0.7	3,183	2,974	3,244	(1.9)	7.0
Net interest income	21,743	20,769	4.7	6,929	7,410	7,351	(5.7)	(6.5)
Other operating income	933	752	24.1	285	204	152	87.0	39.3
Fees and commission income	7,892	7,849	0.6	2,768	2,559	2,586	7.1	8.2
Net income from forex dealings	1,750	1,540	13.6	528	753	297	78.0	(29.9)
Total non-interest income	10,576	10,141	4.3	3,581	3,516	3,035	18.0	1.8
Total income	32,319	30,910	4.6	10,510	10,925	10,385	1.2	(3.8)
Less operating expenses	16,533	14,709	12.4	5,652	5,335	4,871	16.0	5.9
Operating profit	15,786	16,201	(2.6)	4,859	5,590	5,514	(11.9)	(13.1)
Bad debt charge	(1,273)	(2,562)	(50.3)	(2,366)	763	(4,071)	(41.9)	(410.1)
Exceptional items	132	99	33.2	(9)	71	7	(238.0)	(113.2)
Profit before income tax	14,646	13,738	6.6	4,670	4,898	4,468	4.5	(4.7)
Less tax	(4,332)	(4,202)	3.1	(7,167)	1,450	(6,834)	4.9	(594.4)
Profit after tax	10,314	9,536	8.2	3,174	3,448	2,899	9.5	(8.0)
Attributable Income	10,314	9,536	8.2	3,174	3,448	2,899	9.5	(8.0)
EPS (KES)	1.76	1.63	7.8	0.54	0.59	0.50	8.5	(8.0)

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES MN)

Year End: December	3Q18	1H18	3Q17	y-y% ch	q-q% ch
Total shareholder's equity	70,886	68,018	67,338	5.3	4.2
Minority interest	815	770	(176)	(562.2)	5.9
Total Equity	71,701	68,788	67,161	6.8	4.2
Deposits due to other banks	1,520	3,194	1,226	24.0	(52.4)
Customer deposits	296,084	296,965	288,964	2.5	(0.3)
Borrowed funds	25,981	18,426	27,989	(7.2)	41.0
Other liabilities	8,865	11,055	2,959	199.6	(19.8)
Total equity and liabilities	404,153	398,427	388,299	4.1	1.4
Central bank balances	23,323	23,223	24,101	(3.2)	0.4
Deposits due from banks	16,492	13,453	12,035	37.0	22.6
Investment securities	85,812	83,129	71,189	20.5	3.2
Held for dealing securities	-	-	-	-	-
Customer loans and advances	254,207	251,110	259,390	(2.0)	1.2
Other assets	16,097	19,228	12,630	27.5	(16.3)
Intangible assets	1,336	1,324	1,317	1.5	0.9
Fixed assets	6,886	6,960	7,637	(9.8)	(1.1)
Total assets	404,153	398,427	388,299	4.1	1.4

(Source: Company, DBIB Research)

INVESTMENT RETURN

	3Q18	1H18	3Q17	y-y bps ch	q-q bps ch
ROA (%)*	3.4	3.6	3.3	13	(18)
ROIC (%)*	3.5	3.7	3.3	19	(22)
ROE (%)*	19.2	20.8	18.9	25	(158)

(Source: Company, DBIB Research)

*Annualized

CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	3Q18	1H18	3Q17	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	16.3	15.7	15.6	70	60
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	16.3	15.8	22.3	(600)	50
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	40.7	36.9	34.2	650	380
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-
Leverage Ratio (%)	17.5	17.1	17.3	20	47
Equity-to-Loans Ratio (%)	28.2	27.4	25.9	231	81
NPL Ratio (%)	10.5	10.1	6.1	433	35
NPL Coverage Ratio (%)	34.6	28.8	34.7	(9)	575
Long Term Debt to Total Liabilities and Equity (%)	6.4	4.6	7.2	(78)	180
NTA/share (KES)	11.9	11.4	13.5	(165)	49
Book value/share (KES)	12.1	11.6	13.8	(169)	49

(Source: Company, DBIB Research)

**Total Loan Portfolio net of Interbank Lending

OPERATING PERFORMANCE

	3Q18	1H18	3Q17	y-y bps ch	q-q bps ch
Yield on interest earning assets (%)*	11.6	12.0	11.6	(6)	(40)
Cost of funds (%)*	3.8	3.7	3.8	(4)	2
Net Interest Margin (%)*	7.8	8.2	7.8	(3)	(42)
Loan-to-Deposits ratio (%)	85.9	84.6	89.8	(391)	130
Loan-to-Dep.& Borrowed Funds ratio (%)	78.6	78.8	78.8	(29)	(26)
Funded Income Generating Potential (%)	88.2	87.3	88.2	(2)	95
Funded Income Reliance (%)	67.3	67.9	67.2	8	(65)
Cost to income ratio (%)	51.2	49.9	47.6	357	126
Pre-tax margin (%)	45.3	45.7	44.4	87	(43)
PAT margin (%)	31.9	32.7	30.9	106	(83)

(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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