

Recommendation:

BUYTarget Price: **KES 21.00**Price on 28th May 2018:**KES 17.55**

52-week Trading Range:

KES 13.00 to KES 20.00

EPS:

KES 2.35

P/E

7.5X

Q1 ROaE

20.9%

Q1 ROaA

3.6%

Dividend Yield:

9.4%

Market cap:

KES 102.10Bn

Estimated free float:

32.5%

Shares Outstanding:

5867.17 Million

Latest Full Year Results:

The full Year 2017**Analyst**

Victor Cheruiyot Koech

+254711047133

koechv@aibcapital.com

COOPERATIVE BANK

Soaring Eagle manages a comeback in the 1st Quarter...

Co-operative bank (COOP) has just released their Quarter One Full Year 2018 (1Q18FY) recording a strong first quarter performance successfully rebounding from a tepid performance in the same period last year. We iterate our previous target price **KES 21.00** but update our investment recommendation from a **hold** to a **buy** due to the decline of the Group's price on the NSE. We are optimistic that the group's Q1 momentum can only gather more steam, propelled by the current calm political dispensation and the better macroeconomic environment in 2018.

Balance Sheet: Marginal Equity growth despite ECL Implementation

Cooperative bank management grew the group's Total assets grow by **5.1% (YoY)** to **KES 397.8 Bn** in the first Quarter of FY18 (1Q18Y) from **KES 378.5Bn** witnessed in the same period last year. The upswing in Total assets was driven mainly by the **23.8% (YoY)** increase in investments in government securities from **KES 60.5Bn** achieved in **1QFY17** to a new high of **KES 75.0Bn** by **1QFY18**. The group's Loan Book (net) also grew by **2.8% (YoY)**, funded by the **6.5%** increase in Total deposits.

Cooperative Bank's Shareholders' funds rose by **6.9%** on a Year on Year Basis to **KES 67.9Bn** by **1QFY18** from **KES 63.8Bn** recorded in **1QFY17**. This increase can be attributed to a strong net income performance during the quarter and a progressive dividend policy. The shareholder's Equity, however, declined on a quarterly basis due to a one-off caused by the day one implementation of IFRS. In the three months of the first quarter, the group's Shareholders funds declined by a marginal **2.32%** or **KES 1.6Bn** from **KES 69.6Bn** penned at the end of the FY17 to **KES 67.9Bn** by the end of the **1QFY18**. The slight decline in the group's equity was driven by the update of the IAS 39's Incurred Credit Loss (ICL) model with the new IFRS 9's Expected Credit Loss (ECL) model that reduced retained earnings by a one-time **KES 1.3Bn** during the quarter.

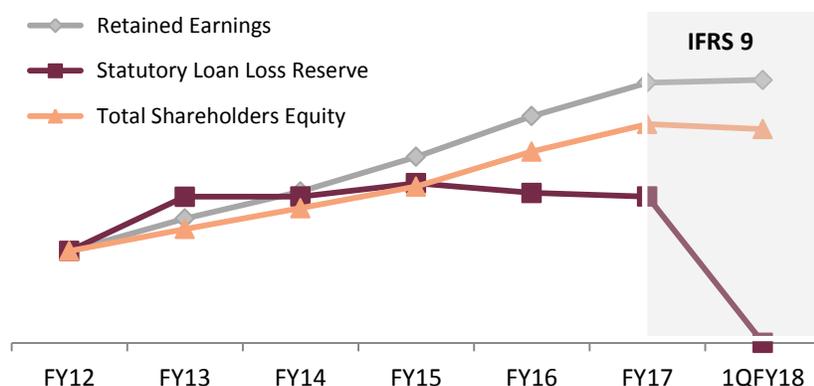


Figure 1: 6-yr Shareholders Equity Trend

NPLs: Asset quality slides further.

The groups' Non-Performing Loans (NPLs) continued on its downward decline to hit **10.9%** in **1QFY18** a full **2.6x** the **4.2%** of NPLs recorded during the same period last year. Management attributes the worsening situation to their portfolio exposure to the real estate and manufacturing sectors that are currently facing macro-economic headwinds. We expect Co-operative Bank's asset quality to continue worsening but improve in the medium term with the repeal of the interest and improvement of the business environment.

CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 2

Income Statement: *Record Q1 high-interest income from loans and advances...*

The group just like its Tier-one peer's Equity, KCB & Diamond Trust Bank managed to grow its interest income on a Year on Year basis, by **9.5%** to **KES 10.4Bn** in **1QFY18** from **KES 9.5Bn** penned in **1Q17FY**. The growth of interest income in the **1Q18FY** was driven by an increase in interest income from both lending and government securities. Interest income from loans and advances during the first quarter of 2018 grew by **8.83% (YoY)** to hit a new Quarter One high of **KES 8.35Bn** in **1QFY18** from **KES 7.67Bn** achieved in **1QFY17**, a deserved pay off for managements' decision to grow its loan book during the quarter.

The momentum from a surging Interest income and Non-Funded Income overcame the **13.1% (YoY)** rise in staff cost and the **5.0%** increase in the cost of funds to grow the bottom line in **1Q18FY**. The Profit After Tax (PAT) and Basic EPS both grew by a respectable **6.8% (YoY)** in **1Q18FY** to hit **KES 3.4Bn** and **KES 2.35** respectively up from **1Q17FY** PAT of **KES 3.2 Bn** and Basic EPS of **KES 2.00** respectively.

The Return On average Equity (ROaE) in **1QFY18** decelerated to **20.9%** from the **21.7%** recorded in **1QFY17**, pushed down by a strong growth in average Shareholders' equity (**6.9% YoY**) that overwhelmed the growth of net income (**6.8% YoY**) over the period. The return on average assets (ROaA), however, remained flat during the period at **3.5%** and **3.6%** in **1QFY18** and **1QFY17** respectively largely due to the approximately equivalent growth of Net Income and average Assets during the three month period.

Challenges: *The dilutive effect on ROaA and ROaE of the group exists.*

The group is still very dependent on The Co-operative Bank of Kenya Limited to deliver a significant portion of its bottom-line. Amongst the five subsidiaries, the Kenyan Bank is still the monolith when it comes to creating value for stakeholders, bringing in **95.9%** or **KES 4.6Bn** of the group's **1QFY18** total Profits Before Tax (PBT) of **KES 4.8Bn**. This significant PBT contribution in **1Q18FY** of the Kenyan subsidiaries came about despite the company owning only **98.9%** of the group's assets. If the profitability of the Kenyan outfit were to be considered in isolation, the Kenyan Bank by itself contributed a **4.34%** Return on average Assets (RoaA) which was diluted to **3.6%** upon consolidation of the group's results. The Kenyan Bank returned **25.7%** in RoaE in **1Q18FY**, which on lower net income and higher Equity value of the group was diluted to the group's RoaE of **20.9%**

Outlook 2018:

The Opportunity exists for management to drive the group's NPLs downwards and improve its asset quality with the recovery of the economy in 2018. We currently project that Co-operative Bank will grow its EPS by **12.5%** to **KES 2.18** by the FY18 from a FY17 EPS of **KES 1.94**. The growth in EPS will be enabled by the increase in Non-funded income, a renewed focus on cheap retail deposits and acceleration of interest income over the second half of 2018. We also expect FY18 ROE to improve to reach **21%** up from FY17 ROE of **17.4%**.

Valuation:

Co-operative Bank is currently trading at an enticing multiple of a **P/E** of **7.4X** compared to the Sub-Saharan **P/E** of **9.2x** but fairly valued if its P/B of **1.52x** is compared to the peers multiple of a P/B of **1.5X**. We iterate our previous target price **KES 21.00** but update our investment recommendation from a **hold** to a **buy** due to the decline of the Group's price on the NSE. We expect positive news in the second Quarter and the increased investor confidence in the banking sector to drive the counter up towards its fundamental value.

AIB Capital Research

Research Analysts, AIB Capital Research

Willis Nalwenge

nalwengew@aibcapital.com
(+254) 711047105

Victor Koech

koechv@aibcapital.com
(+254) 711047133

Equity Dealing Desk

Chief Dealer, AIB Capital Equities

Bernard Kung'u

kungub@aibcapital.com
(+254) 711047108

Head of Institutional Trading, AIB Capital Equities

Bernard Gichuru

gichurub@aibcapital.com
(+254) 711047111

Equities and Derivatives trader, AIB Capital Equities

Brian Tanui

tanuib@aibcapital.com
(+254) 711047124

Research Disclosure

Though utmost care has been taken in the preparation of this report, we do not guarantee the accuracy or completeness of the information contained herein nor will AIB Capital Ltd be held liable for the information contained herein.

The views expressed in this report are solely those of the Research Department and are subject to change without notice.

The information in this report is not an offer for the sale or purchase of any security. This document should only be considered a single factor used by investors in making their investment decisions.

This publication may not be distributed to the public media or quoted or used by the public media without prior and express written consent of AIB Capital Ltd.

NOTICE TO US INVESTORS

This report was prepared, approved, published and distributed by AIB Capital Limited Company located outside of the United States (a non-US Group Company"). This report is distributed in the U.S. by LXM LLP USA, a U.S. registered broker-dealer, on behalf of AIB Capital Limited only to major U.S. institutional investors (as defined in Rule 15a-6 under the

U.S. Securities Exchange Act of 1934 (the "Exchange Act")) pursuant to the exemption in Rule 15a-6 and any transaction effected by a U.S. customer in the securities described in this report must be effected through LXM LLP USA.

Neither the report nor any analyst who prepared or approved the report is subject to U.S. legal requirements or the Financial Industry Regulatory Authority, Inc. ("FINRA") or other regulatory requirements pertaining to research reports or research analysts. No non-US Group Company is registered as a broker-dealer under the Exchange Act or is a member of the Financial Industry Regulatory Authority, Inc. or any other U.S. self-regulatory organization.

Analyst Certification. Each of the analysts identified in this report certifies, with respect to the companies or securities that the individual analyses, that (1) the views expressed in this report reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly dependent on the specific recommendations or views expressed in this report. Please bear in mind that (i) AIB Capital Limited is the employer of the research analysts responsible for the content of this report and (ii) research analysts preparing this report are resident outside the United States and are not associated persons of any US regulated broker-dealer and that therefore the analysts are not subject to supervision by a US broker-dealer, and are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with US rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

Important US Regulatory Disclosures on Subject Companies. This material was produced by Analysis AIB Capital Limited solely for information purposes and for the use of the recipient. It is not to be reproduced under any circumstances and is not to be copied or made available to any person other than the recipient. It is distributed in the United States of America by LXM LLP USA and elsewhere in the world by AIB Capital Limited or an authorized affiliate of AIB Capital Limited. This document does not constitute an offer of, or an invitation by or on behalf of AIB Capital or its affiliates or any other company to any person, to buy or sell any security. The information contained herein has been obtained from published information and other sources, which AIB Capital Limited or its Affiliates consider to be reliable. None of AIB Capital Limited accepts any liability or responsibility whatsoever for the accuracy or completeness of any such information.

All estimates, expressions of opinion and other subjective judgments contained herein are made as of the date of this document. Emerging securities markets may be subject to risks significantly higher than more established markets. In particular, the political and economic environment, company practices and market prices and volumes may be subject to significant variations. The ability to assess such risks may also be limited due to significantly lower information quantity and quality. By accepting this document, you agree to be bound by all the foregoing provisions.

LXM LLP USA assumes responsibility for the research reports content in regards to research distributed in the U.S. LXM LLP USA or its affiliates has not managed or co-managed a public offering of securities for the subject company in the past 12 months, has not received compensation for investment banking services from the subject company in the past 12 months, does not expect to receive and does not intend to seek compensation for investment banking services from the subject company in the next 3 months. LXM LLP USA has never owned any class of equity securities of the subject company. There are not any other actual, material conflicts of interest of LXM LLP USA at the time of the publication of this research report. As of the publication of this report LXM LLP USA, does not make a market in the subject securities.