Conference Call transcript

19 November 2019

Q3 2019 RESULTS

Operator
Good day ladies and gentlemen and welcome to the Co-operative Bank of Kenya Q3 2019 financial results. All participants will be in listen-only mode. There will be an opportunity to ask questions later during the conference. If you should need assistance during the call please signal an operator by pressing star and then zero. Please note that this call is being recorded. I would now like to turn the conference over to James Kaburu. Please go ahead, sir.

James Kaburu
Good morning, good afternoon, good evening ladies and gentlemen. Once again welcome to the Cooperative Bank of Kenya conference call to discuss third quarter 2019 financial results. With myself I have Anthony Muli, who is our bank Economist. I have Mr Alois Ngure who is our Senior Manager in the Credit Management division. I also have Samuel Oyugi, also a Manager in the same division, Credit. I have a Mutahe Karuoro, a Manager in the Treasury Department, and myself, James Kaburu, Head of Investor Relations and Strategy. Mr Patrick Nyaga, the group CFO, may be joining us in the course of the conference call because of some urgent engagement. I now welcome you and invite Anthony Muli to take us through the macroeconomic environment before I take up the other portion.

Anthony Muli
Good day ladies and gentlemen. On the macroeconomic theme we've seen some parcels of softness on the Kenyan economy. GDP registered 5.6% growth in the second quarter of 2019. This compares to about 6.4% in the similar period in 2018. We have obviously seen high growth in ICT, transport and obviously the public sector. I think key to note is a bit of the agriculture sector suffered from low commodity prices compared to the previous period last year. We have also seen a bit of the unpaid bills both from the public and private sector draw back growth in some of the sectors, especially trade and a bit of the local manufacturing. Similarly we've also seen most of the importation being on the consumer front, and the government-led projects obviously have a long gestation period so that hasn't been materialised in the medium term. So a bit of that growth will be realised in the long term.

On the money market front fairly flattish in terms of the short-term paper. We have also seen the interbank regime quite low in the sense that currently the interbank is an average of 3%. This speaks to high liquidity within the banking sector being driven by both the banks and also a bit the fund managers who are chasing government paper. On inflation we don't have many worries into the close of the year. We are looking at overall inflation closing the year within the 7.5% range. Obviously the caveat here is that we will not witness any geopolitical shocks around oil prices. I think most of you are aware that currently on the oil theme I think the main challenge is demand rather than the supply. The Kenyan Shilling has remained fairly stable in the period to September 2019. Obviously we saw a bit of volatility around the 23rd July, but that has been managed well. I think going forward we have also seen the current account deficit trying to converge towards a projected 4.5% by close of the year. However, looking at that outlook it shows that that wasn't realised by an increase in export which would have been a better story as opposed to falling imports.

On the private sector credit growth we've seen a bit of increase. We are looking at credit growth of 6.3% in August 2019 compared to about 3% earlier in the year in January. This also compares to about 4.3% in August last year. Most of this growth is in trade, manufacturing and towards the [unclear]. That speaks to asset finance and check off [?] loans. In South Sudan I think the crux of the matter is that we are looking forward to both parties getting into an agreement by February 2020. Thank you. I think I will invite James Kaburu to take us through the financials.

James Kaburu
Thanks Anthony. We have already shared the PowerPoint presentation to yourselves, so what I'll do is I will take you through some of the trends, not going through all the slides. Starting with slide number nine, which is the strategic focus, and number ten, we have not changed our strategy. We are still focussing on the same alignment. And so I will go to slide number 11 which is about our group structure and the model, again really not changing from the previous quarter, remaining the same. On slide number 12 is our presence, currently having 157 branches, 4.7 million MCo-op Cash customers – these are the digital customers – over 16,000 Co-op Kwa Jirani. Co-op Kwa Jirani is our agency model. So we have over 16,000 of them. Our ATMs remaining 586, with 89,000 customers dealing with the bank through the internet banking solution, again with 464 members through the SACCO front office dealing with the bank through that method, and again with over 16,000 customers from the diaspora. In terms of the total account holders at the moment we have 8.7 million with a staff number of 4,541.

When you move to slide number 13 we have really not changed the model. Again I will not go through that one. Number 14 is on transformation which we started way back in 2014 which we continue pursuing. Slide number 15 is again still on transformation, showing a number of activities which we are still embarking on, on MSME, on e-credit, on omni-channel which we are just about to launch before the end of this month, core banking solution which we are now changing to a new one from early next year where we have already formed a project team and in the state of identifying a good software to take us to the next level for the next five years, and again still working on data analytics and a number of initiatives.

On slide number 16 again this has socio-economic empowerment which we continue pursuing, showing the consultancies 2,800 we continue doing for the sector, especially the Credit Union, and the other socio being the Foundation where we continue educating bright but needy students. And there are a number of initiatives. When we go to slide number 17 it just indicates the number of awards we've been able to get this year. I'm happy to say that last week on Friday we were the winner of the Catalysts Awards which are normally done by the Kenyan Bankers Association. We were the overall winner. And apart from that we got about seven other awards. Apart from that we also got an award which was awarded in Germany for global SME finance in 2019. Locally also we have a financial reporting which is organised by Institute of Certified Public Accountants of Kenya, Capital Markets and the Nairobi Securities Exchange. And we won the best prize for environment sustainability reporting, and also another award from the Kenya Association of Manufacturers which was for sustainable finance.

When you go to slide number 18 it shows how we are performing in the region, our region being South Sudan. Sudan continues to face some challenges because the two protagonists have still not agreed. So you find what we are doing is just trying to maintain the business. The loan book at the moment is still about KSh 1.6 billion with a total asset book of KSh 5.7 billion, customer deposits of about KSh 3.2 billion, and profit before tax of KSh 175 million, slightly down from what we recorded same time the previous year.

When we go to the next number of slides starting from slide number 20 it basically shows how we are doing in terms of our channels, the first being on slide number 20. It shows in terms of agency banking currently we have about 36 million transactions, up from about 33 million transactions same period last year. ATMs slightly going down from 29 million last year to 27 million. Internet banking slightly going up to 1.7 million from 1.5 million last year. Transactions through our branches slightly going up this time to 13 million from 10 million. And a slight increase on merchant POS banking, 481,000 up from 359,000. You will note that 89% of our customers are transacting through the various alternative channels. And of course we are still very heavy on e-credit and this year January to date we have already done KSh 27 billion disbursements through that channel.

If you come to the next slide, which is number 21, it is more talking about e-credit. And in terms of the customers who are now signed to our e-credit they are nearly 4.2 million customers. And in terms of disbursements to date what we have disbursed on e-credit is KSh 48 billion, much of that of course having been disbursed in the first three quarters of this year. When we go to other sectors, this is slide 22 on mobile banking, you realise that in terms of transactions on MCo-op Cash we have gone to 38 million, up from 27 million last year. In terms of commission income a high of nearly KSh 3.4 billion from KSh 1.3 billion last year. That is over 100% growth. And deposits through this platform currently about KSh 93 billion, up from KSh 70 billion the same time last year.

When we go to the next slide again on agency banking – this is where we bank through the agents – you realise right now we have 16,934 agents, up from last year where we had 11,672. Total revenue generated through that channel is currently KSh 373 million, up from KSh 347 million last year, with transactions also going up to 36 million from 33 million last year. Deposits slightly going down. Last year we had KSh 242 million from that channel. Right now they have slightly gone down to KSh 216 million. What is happening is you realise that the transactions have increased, but just because of lower balances by the customers operating this channel at the moment that explains the lower deposits generated by the channel. But the transactions are higher.

When I go to the next number of slides starting from slide number 25 – this is our financial position – you realise that our total assets have grown from KSh 404 billion to KSh 441 billion this year. The loan book has grown from KSh 254 billion last year to KSh 269 billion in the current quarter, with total deposits growth from KSh 298 billion to KSh 324 billion, and shareholders funds also growing from KSh 71 billion to KSh 74 billion. The next line shows the same in terms of percentage. Total assets I've talked about, a growth of 9.1% last year on this year. Loan book 6%. Government securities growing by 13.6%. Total deposits by 8.8%. Borrowed funds 14.4% with shareholders' funds also growing by 4.3% and customer numbers growing by 14.5%.

When we look to slide number 27 this one is a breakdown of our asset book and our loan book where out of our total loan book currently 25% comes from corporate with mortgage giving us 13.1%. You realise mortgage has reduced from 17.3% to 13%. Corporate has nearly stayed the same. Asset finance is growing slightly from 5.6% to 6.2%, with SME dropping from 9% to 6.2%. Micro remaining nearly the same, but we are seeing the biggest growth in personal banking. This is a check-off system which has grown from 33.6% to 38.4%. Agri business is remaining nearly the same, 1.3% against 1%. And SACCO banking slightly going up from 8.2% to 8.9%. If you look at the same book again broken down in terms of segmentation you realise again personal and consumer banking is our biggest book at the moment at 42%, having grown from 37%. The other book which has grown slightly is financial services, which has grown from 10% to 12%. This is mainly the Credit Union and the micro finance, lending to those units. When you look at the majority of the others they have shrunk in terms of percentage, real estate shrinking from 15% to 11%, transport also going up slightly from 8% to 9%, but trade shrinking from 15% to 14%, building and construction relatively staying the same, energy shrinking by 1% from 7% to 6%, manufacturing from 3% to 2% and the agri business nearly the same at 2%.

The next slide we move to our liabilities book. You will find 54.7% of our liabilities in terms of deposits are generated from sticky and stable deposits. These are transaction accounts accounting for 30.1%. And current accounts accounting for 29.4% with savings accounting for 5.2%. The balance of about 35% is coming from the fixed and core deposits which are a bit costly. In terms of breakdown of that book you realise again where we have tried to grow the book this year is on retail and SME, retail growing slightly to 24% and SME growing to about 19%. Co-operative banking remaining nearly stable. Institutional banking also slightly growing to 21.4%. Government banking because of the continued Treasury Single Account shrinking from 13% to 11%. Micro credit slightly going up from 9.9% to 10.6%. And the agri business and the SACCO banking remaining stable at around 7% and 0.4%. In terms of how that book is placed both the funding and loan book you will find the majority of our balance sheet is in Kenyan Shillings. We have about 12% of the loan book coming from forex denominated, and again about 11% of our funding also coming from forex denominated, mostly Dollars.

When we move to slide number 31 again this is a breakdown of our loan book in terms of quality of the book. Currently with a book of KSh 231 billion, which is 80% of the book, being normal, with KSh 26.5 billion being on watch. This breakdown is based on our central bank regulatory guidance [?] and the book which we feel requires specific provision starting from substandard coming to 4% of the book, which is 10.3%, and doubtful coming to 18.6%, which is 6% of the book, and just about 0.2% of the book being a loss category. And again giving us a total gross book of KSh 287 billion.

Operator
Ladies and gentlemen, we have been re-joined by the main speakers. You may go ahead, sir.

James Kaburuuru
Good afternoon once again. Good morning, good evening. Sorry for that, but we can continue. I will start very quickly from slide number 31. This I was talking about our quality loan book where we have distributed our loan book of KSh 287 billion between normal, 80%, 9% in watch category, 4% in substandard, doubtful 6% and the loss being 0.2% with total non-performing book of 29.47 billion remaining stable for the last three quarters. Going to slide number 32, a breakdown of the same book but now in terms of provisioning using IFRS 9, with stage one giving us KSh 2.7 billion, stage two KSh 800 million, stage three KSh 16.45 billion, giving us a gross non-performing book of KSh 20 billion.

If I move to NPLs broken down by the amount of NPL in that book, we find in manufacturing we have the highest NPL at 65% of total book in that segment, the others remaining much more stable, with a slight increase also in trade and the building and construction. If you go to slide number 34 it is the same NPL book broken down by the total NPL book with the trade being the highest composition of NPL at 32%. But you will note that trade is where we have the biggest lending of the KSh 287 billion we've lent. Personal also slightly going down from 20% to 18%.

If I move quickly to the next slide on coverage, we see coverage of IFRS we have moved to a high of 55% from 36%. And with CBK provision we are now at 66.5% from 53% with our cost of risk going up to 1.1% from 0.7%. In terms of capital ratios core capital to total risk weighted assets at 15.4% against 10%, total capital 15.7% against a statutory minimum of 14.5%. But what I was indicating is when we put our total net book profit at the end of year to this ratio it is going to increase. It was going to give us another 200 basis points so we are not very worried that it has really shrunk. Core capital to total deposits, a high of 20% against a requirement of 10.5%. Slide number 37 is just a breakdown of our asset book, not changing but remaining stable. Slide number 38 is on liquidity. Quite high at 45%, and with total loans to deposit of 83%. And the loans and borrowed funds at 76%.

Coming to slide number 39 is a breakdown of our subsidiary performance with the bank contributing KSh 14.7 billion profit which is a 6% increase from last year. Co-op Consultancy and Bancassurance KSh 511 million, which is a 36% growth from last year. Co-op Trust, which is our fund management company, contributing KSh 51 million, which is a 33% increase. Kingdom Securities, which is our brokerage company, giving us a loss, but a lower loss this year because of the prevalent market conditions which have been there in the stock exchange. It is a loss of KSh 10 million but a growth of 33% in terms of reducing their loss which they made last year. Co-operative Bank of South Sudan also reducing by 26% from KSh 235 million to KSh 175 million. Then this gives us a total book of KSh 15.4 billion which is a 6% growth. CIC Insurance, an associate also has dropped currently to KSh 22.7 million against KSh 132 million which is an 83% drop last year. This gives us a total profit before tax of KSh 15.5 billion which is a growth of 6%, and net of tax of KSh 10.9 billion which is again a growth of 6%.

When we come to the breakdown of that profitability you find that net interest income has slightly reduced by 2.7%. That is from KSh 21.7 billion to KSh 21.2 billion. But fees and commissions have increased quite a lot by 46.6% from KSh 7.9 billion to KSh 11.6 billion. Forex slightly going down by 7.7% and other income by 2.5%. We have increased our provisions by 66.8% from KSh 1.3 billion to KSh 2.1 billion. And profit before tax, what I just indicated, by 6.3% from KSh 14.5 billion to KSh 15.4 billion. And with associates KSh 15.5 billion against KSh 14.6 billion which is a 5.5% growth. And also a growth in earnings per share from KSh 2.3 to KSh 2.5 .

On slide number 41 is just a breakdown of a few ratios. Return on assets of 3.4%, return on equity at 20%, earnings per share 2.5%, NIM slightly going down to 7.2%, and cost to income ratio slightly down, 50% against 51% last year, and NIM of loans about 7.5%, slightly down from 8.5% last year. The final slide is slide number 42 which is just an outlook of what we are expecting to find in the full year, an outlook of 11% growth which we expect to close the year with in terms of PBT. Loans 11% and deposits we expect to grow by 10%. Cost to income ratio about 50%. Total non-funded, we expect to have about 40% coming from non-funded, with a return on equity of about 22% and a return on assets of about 3.5%. And the NPL slightly to reduce from the current 10.5% to around 10%. Cost of funds remaining stable about 3.6%. NIMs we feel we can slightly increase to about 8%, cost of risk to about 1% to 1.1%. And thank you so much very for that conversation. I think now we can give some options for questions and answers. Thank you.

Operator
Thank you sir. Ladies and gentlemen, if anyone would like to ask a question you're welcome to press star and then one on your touchtone phone. If you however wish to withdraw your question you may press star and then two to remove yourself from the question queue. If anyone would like to ask a question please press star and then one. Our first question is from Adesoji Solanke of Renaissance Capital.

Adesoji Solanke
Hi. Good afternoon. Thanks for the call. This is Soji from Rencap. I have a few questions. The first one is with respect to the removal of the rate caps. Can you just talk a little bit about when you expect to start offering new loans at the market rates, and by how much higher your lending rates go? Also, can you perhaps give an update on the revised risk pricing model being set up by the CBK and when you expect this to be released? My third question is with respect to your outlook for margins in 2020. Do you have a sense of what you see happening to your margins next year? And my fourth question is with respect to non-interest revenues, specifically fee and commission income. Like you mentioned that line is up 47% this year. What exactly is driving this and how do you envisage this line trending for 2020? Are there some one-offs in there perhaps? I will leave it there for now. Thanks.

James Kaburu
Okay, thank you, Soji. We will take up the questions before we take some others, because there are a number of them. And I think I will give Mr Ngure from credit to take up a number of those questions.

Credit Department
Thank you James. I think the first question about the rate cap removal I know it's something that is in the public domain. What we are doing right now is to maintain our pricing model as is so that we are able to not disrupt the market. And again a more [unclear] environment because most of the parameters that are supposed to change within the next six months we don't expect so much. But [inaudible] review and agree on the precise pricing model that we need to deal with, noting that in as much as the cap was lifted what was so critical even from a central bank perspective is a clear, deliberate way of not having the pricing go way above what is expected from an average pricing. So I think for us is to review and wait and see how well the market will play. MPC, that monetary policy committee of course will meet next week. It will be interesting to hear after the interest rate cap what their position is around that.

So from a banking perspective – and I think this is also what you meant about whether central bank has revised its pricing model – I think this is being left to the banks to determine, of course central bank being the bank to commercial banks and supervisor to ensure that they are within rates. So what is expected maybe in due course is to have some levels of risk based pricing models, which of course internally we are having a view and discussing around it. So it is an interesting turn of events and again we want to act responsibly. And also once the effective demand of lending is created of course there will be fairness in terms of the pricing matrices we will adopt across the lending segment. So I think I've covered the issue of the revised pricing model which basically there will be some model that will be coming. And I think of course this is a work in progress that we track and we will of course update you maybe in the next call. NFI, I think this is something I could request my colleagues to put a word on it. James, you can take this one.

James Kaburu
Thank you Soji once again. On NFI what we have seen is what has driven NFI this year so much actually is our e-credit model. If you look at the presentation I've just given you realise in terms of revenues to date we have received nearly KSh 3.4 billion from a low of KSh 1.3 billion last year. We are currently disbursing as much as KSh 5 billion per month on e-credit. This is a strategy we want to continue pursuing even next year. So this is an area we still expect to continue growing commission. The only slight change we feel is maybe the current margin we are making from e-credit now that capping has been lifted we may find the regulator trying to come in in terms of trying to regulate the e-credit, meaning we may not continue making as high margin as currently we are making. But we are going to compensate that with volume. Our target is to continue growing the book in terms of that so that if the margin reduces the volume more than compensates for that. So when we are looking at next year projections we still feel we can do about 40%of total revenues coming from commission income. Again also remember that with the lifting of the capping we are also going to go big in terms of lending. We are looking at growing the loan book by about 15% next year. That also comes with loan fees and other commission related. And we are feeling that is also going to boost our commission income.

Adesoji Solanke
Okay. I think the other question I had was when you are speaking about the margins you charge on these e-credit loans what do you currently charge and how do you split that between interest and non-interest?

James Kaburu

Currently we are charging 7% but 100% of it is going to commission, apart from we have some products on e-credit which is to business customers. About 10% of the book. That is the book which is capped currently at 13%. But 90% of the book is on commission which is going to commission income.

Adesoji Solanke
And this starts this year? Did you start charging 7% this year?

James Kaburu
No, we started late last year.

Adesoji Solanke
That's fine. I have a few other questions but I will ask them later on. Thanks.

James Kaburu
Okay. Thank you.

Operator
Ladies and gentlemen, if anyone else would like to ask a question please press star and then one. Adesoji, you can go ahead with your other questions if you wish.

Adesoji Solanke
Okay sure. So my other question was the rise in branch banking, what is driving the increase in transactions done at the branch? Because this is unlike what we are seeing happening with your peers. Are you facing some challenges with your digital channels? Then my second question is the decline in mortgage lending. What is driving that vis-à-vis the growth you have seen in personal consumer? If you can just talk about the trends in those buckets of your loan book. Then my third question is the manufacturing book. Why is it so bad? I think from your slide you have about 65% of that book bad. If you can just talk about the trend in the manufacturing sector and what the outlook for NPLs over there is. Thank you.

James Kaburu
Okay. I will on branch banking, then Ngure can talk about the mortgage and manufacturing book. There is a slight increase in transactions in branch banking, but really it is not so much about the service, but what has happened is after we moved a large number of customers from the brick and mortar branch we started growing also the section of high net worth customers. We have started seeing a number of increasing revenues coming from that area of high net worth customers who prefer to come to the branch. But what we have done is we have created some sections for them, which have a better look and feel, and we have seen an increase in that. The other thing is we have taken to sell more the agency banking was to try to bring some of these agents to the banking hall to try to get an experience of how to do it. Then after that, after they have gotten that experience of customer experience then we take them back to their offices and shops. So what has happened is we had a number of branches which customers were coming and transacting through the agents, but some of them through the branch. But actually we have now changed that model because we have trained the ones we wanted to train. And from next week we won't have any agent also sitting in the bricks and mortar branch. I will give Alois a chance to discuss your two other questions.

Credit Department
Thank you James. As regards to mortgage lending, that marginal decline, I think from where we sit and from a risk assessment what we have noted is more a reduced appetite on these products. It is coming from a [unclear]

financing from the retail space. People have not been able to take up mortgage products based on the market dynamics that have been there. So this marginal decline is more driven by the demand and also the risk profile which has also been high in the last couple of months. So do we expect this to change? Well, it will also be driven by the purchasing power parity that will be created once we see the main macroeconomic aspects and people's ability to service long-term facilities coming in. On the bit on manufacturing, James has already alluded to this. Yes, it's an interesting situation because that peak that is showing in that graph is one name that again as much as it has gone to the doubtful we are proactively managing that name. And we are seeing the results of that. The manufacturing is now back to operation. There is cash flow being generated. We can see throughput coming through. So this is one of the accounts that we are optimistic of its turnaround. So an upgrade of this account will be there. So the bank exposure, the NPL of the manufacturing is actually under that name. So are we seeing a growth in the manufacturing sector? Again it is a wide sector so there are pockets of growth that we will be able to look at. But of course [unclear] such an enterprise.

Adesoji Solanke
Then just a last question from me. In terms of the outlook for margins for next year, so your margins have continued to decline this year, but I think they are bottoming out where they are currently. But going into next year with your views on the interest rate environment, what you're likely to see in terms of credit growth at potentially high rates next year, on balance what do you think happens to your NIMs in 2020?

James Kaburu
Soji, that's a good question. Actually as we project to next year now the good thing is we have seen interest rate capping being removed. We are projecting an increase in margin actually to a basis of about 200 to a high of about 300 basis points. That is where we feel we can increase our margin now that the capping has been removed, and again we see some sectors where we can increase that margin and still lend profitably and still be able to increase our loan book.

Adesoji Solanke
So help me understand. So your legacy loan book stays as it is. Next year…

James Kaburu
Again you note that this is now for the new loans we are going to disburse, not the existing book. The existing book for now we are not changing. But the new book is where we are looking at repricing as we start lending to the new book. But not immediately. You remember the strategy. Alois has talked about where we are waiting and seeing. But going towards next year we feel we will be able to start disbursing at those rates.

Adesoji Solanke
Okay. Just to make sure I understand what this number means, so next year you think your net interest margin could expand about 200 basis points at the minimum?

James Kaburu
We feel we can do about 200, yes. What we've done is we are working on a strategy where we try to manage the cost of funds because of course the margin is an element between both loan book and the yield and the cost of funds. So we feel right now what we are pushing much more is to have a cost of funds, maintain the cost of funds, not really grow it but actually try to get more deposits from the retail section. So we are really not increasing the cost of funds but benefitting by the increase in yield and by the new loans we are giving.

Adesoji Solanke

Okay. And what sectors drive this margin expansion next year?

Credit Department
I think our personal lending space we will continue seeing traction there. This is more of a SACCO facility. And, well, depending on how the macroeconomic environment changes the SME, small and medium enterprise is an area that we would be able to see how much we can cover. Of course this is depending on the macroeconomic changes that we expect to see. So household credit, of course private credit, is an area that as you have noted this year will be sustained. So I'm looking at those two areas. Of course corporate is an area that we want to grow but in a more conservative way. This is basically into the sectors that are having a better growth rate. So those are the three areas I would say that we can expect some level of growth into 2020.

Adesoji Solanke
Thanks. Because your legacy loan book pricing stays as it is, as those loans mature and roll over you can reprice those at market rates, right?

Credit Department
Okay. Market rate is a new rate we are thinking of. For example once we restructure or you do a top-up that is a time now someone can change the rate. But the existing ones you can't change. We are not expecting to see a change in that. That's why I was talking of… The increase I have talked about is for new loans. But when you weight it together with the existing we expect the margin to be about 9% when you do a weighting with the existing book and the new book now.

James Kaburu
So it is clear the legacy loans' pricing remains constant. That is what the law is clearly articulating. So whether those contracts – because they are contracts – subject to renewal of those contracts with a client, particularly on the tenure, particularly on those working capital facilities that are renewable every year, the prevailing pricing then shall reign. But mostly the term facilities that are already locked into a tenure I do believe the legacy pricing will continue.

Adesoji Solanke
I think, James, the number you mentioned, when you balance out for new loans and the existing loan book what do you think your net interest margin goes from? You are at 7.5% now as of nine months. Do you think as of next year you are probably at around 9%?

James Kaburu
That's what we think.

Adesoji Solanke
Okay. Then what proportion of your loan book do you think matures over the next one year?

James Kaburu
Sam is going to take up that question.

Samuel
This is Samuel. Now, the question of loan book that is going to mature in the next one year is around 7%.

Adesoji Solanke

Did you say 7%?

Samuel
7%. That is the maturity for the next 12 months.

James Kaburu
Okay. But then there is also the e-loans which we are giving with very high turnover. Currently right now we have already done about KSh 48 billion of e-loans. But because of the turnover you find what is sitting in the book is just KSh 5.9 billion. So when you count that one the percentage is much higher.

Adesoji Solanke
Okay. All right. That's fine. Thank you very much.

Operator
Our next question is from Anne Kahure of SBG Securities.

Anne Kahure
Good afternoon all. Thank you for the call. I have a few questions. With regard to the potential margin improvement next year is there an idea to also drive the funding costs down? And how do you plan to drive this? My second question is with regards to the push to drive SME and retail lending next year. With that in mind what do you think NPLs will look like at the very least for the first half of next year? And with the real estate portfolio – and this is a more general question – do you think the sector will benefit even in the medium term from a rate cap repeal? Or do you think the problems structurally are much worse than just lending rates? And I guess my final question is does the rate cap repeal impact the relationship with SACCOs? So this is a question for both the asset side and the liability side.

James Kaburu
Thank you Anne. I will give Mutahe from Treasury to answer your first question on funding. Then Alois will take your second question on NPL and Anthony can answer the real estate question. Again Anthony can take up the question on rate cap for SACCOs.

Treasury Department
Hello. My name is Mutahe. To your first question, Anne, how we will continue to fund ourselves cheaply or more affordably, basically leverage on our huge retail network as opposed to corporate clients or huge fund managers. We implemented this strategy this year and if you look at the presentation you will note that the retail deposits have grown. So we plan to continue with that same strategy coming into 2020.

Anthony Muli
Good afternoon. This is Anthony. On the question of the real estate and how the rate cap repeal might unlock that sector, our view is we might see a 10% to 20% favourable improvement in the sense that a bit of the banks will obviously take a bit of risk and lend on the end user mortgages. So that might unlock about 10% to 20% of the holdings by some of the developers. So we might see a bit of relief, maybe limited to 20%. But obviously the rate cap will not be the bullet point for that real estate sector. On SACCOs obviously remember that we lend on wholesale terms. And given the risk premium especially for us we are looking at a risk premium on SACCOs… The NPL is less than 1%, so we are looking at no change in pricing for SACCOs post this rate cap review environment. Thank you.

Credit Department
Maybe I will touch on the MSME. I think the question is whether with any growth on MSME we will sustain our NPL ratio to that segment. One of the things that I would want to mention is most of the business drivers around this space are traders. And what we have witnessed is part of the pressure that we have on NPL on this segment is driven by delayed payments from the counties and from the national government as well. So suppliers performed, but of course the payments were delayed. So there is a tweak to the whole aspect of how the government policies around honouring commitments will be, because there is an externality [?] here. So yes, as much as we would want to look at that segment as an area of growth, of course going through the historical aspects around what we have witnessed in that space we may want to approach it with caution and also be prudent with the practise [?] where we may want to actually do the trade business on. So we want to improve it. The NPL that currently we are looking at, we want to reduce it from the level that we are at the moment, not really to increase it. As we grow there is a prudent and cautionary approach to it.

James Kaburu
So I think Anthony has mentioned around the SACCO rate cap repeal, so I do believe that is handled.

Anne Kahure
Yes, yes it is. Just to confirm on the real estate sector, so the expectation here is that there will be an improvement in end user loans – so these are mortgages – but not necessarily the commercial side of the business.

Anthony Muli
That's it. We are looking at unlocking the end user mortgage meaning that the developers who are holding a bit of finished products or properties would be able to dispose of, but maybe limited to about 20% of that. However, looking at the developer side I don't see banks, including ourselves, being able to underwrite any more risk in that sector, especially given the current holdings.

Anne Kahure
Okay. That makes sense. And from an NPL perspective, even if just a rough number, what proportion of your current NPLs is tied to commercial real estate or real estate in general?

Anthony Muli
Well, it is about 14%. So it is the average. It is within there. I think the issue here is to ensure we convert the existing projects that are holding [unclear] are completed, they are offloaded. And the success rate around here is promising because the titling process, which was one of the areas that we were having a delay on, is progressing well. As the economy improves for end buyer financing we expect those guys to be buying those units which will basically help the commercial loans that are there.

Anne Kahure
Okay. That's perfect. Thank you.

Operator
The next question is from Msekiwa Mutukwa of Ashmore Group.

Msekiwa Mutukwa
Good afternoon. Thanks. It's Seki from Ashmore. Three questions please. The first one was just to clarify on the e-credit, the KSh 3.4 billion of commissions. Is that KSh 3.4 billion out of the KSh 11.6 billion? So do we have to

net that off to get a number that contributes to the KSh 11.6 billion? The second thing is if we just look at those commissions divided by transactions over the period compared to last year that increased significantly. I'm just curious to know, is that a meaningless calculation or is there something in there about your ticket size that is relevant to note? And then the final question is just in terms of cost of risk. You have talked about guidance of 100 basis points for the near term. If we look slightly further out on the conservative side or base case, between 120 and 140 basis points cost of risk, does that seem reasonable? If not, why? Thank you.

James Kaburu
To answer you on the question for e-credit, you are right that the KSh 11.6 billion in fees and commissions is composed of the KSh 3.3 billion I talked about from commission from e-credit that is sitting in this line. I don't know whether I have answered you on that part.

Msekiwa Mutukwa
Yes, that's fine. Thank you.

James Kaburu
Okay. The second one on cost of risk I think we gave a guidance of our expected cost of risk even towards next year is about 1.1%.

Msekiwa Mutukwa
I see. Okay.

James Kaburu
The third question I did not get properly. Maybe you can repeat.

Msekiwa Mutukwa
Okay. Sorry. So what I was saying is on slide 22 if you take the commission number you've given and divide that by the transactions – assuming they are linked – that number is higher in Q3 2019 significantly than it was in Q3 2018. And I'm wondering, is that a pointless exercise or is there actually something about the ticket sizes, the ticket sizes of the loans for example, that is different between when you started this last year and where we are today.

Credit Department
I think [inaudible segment] could hold water, the expansion of the various ticket sizes. Because it is not a one fits all. There is a whole graduated [?] type of sizes around each and every e-credit loan to the customer. So there is a spread around the ticket sizes that we are running. [Overtalking].

James Kaburu
Also maybe to add on that one, this year we started with lower disbursements. Like in January we disbursed about KSh 1 billion, but we continuously increase each and every month. And currently we are able to disburse about KSh 4 billion to KSh 5 billion. So there is also that incremental factor.

Msekiwa Mutukwa
Perfect. Thank you.

Operator
It seems we have no further questions on the lines, sir. Would you like to make any closing comments?

James Kaburu
I want to take this opportunity once again to really thank you for participating in our conference call. As we continue discussing the new environment and seeing how the interest rate capping now that it has been removed is taking place what we can do is we can organise for another conference call. But once again I want to take this opportunity to thank you for your participation. Thank you.

Operator
Ladies and gentlemen, that concludes this conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT