Conference Call transcript

18 August 2020

H1 2020 RESULTS

Operator
Ladies and gentlemen thank you for your patience. Welcome to the Co-operative Bank of Kenya's Q2 of 2020 results. All participants will be in listen-only mode. There will be an opportunity to ask questions when prompted. For the benefit of our participants who have joined via the HD web phone, please ensure that if you give your microphone permission to make yourself audio before accessing the question queue. Please note that this conference is being recorded. I would now like to hand the conference over to Mr James Kaburu. Please go ahead, sir.

James Kaburu
Good morning, good afternoon, good evening ladies and gentlemen. I want to start by apologising for the delayed start. We had some technical challenge, that's why we are starting this conference call slightly late, but otherwise we are going to start. I want to first welcome you to the Co-operative Bank Group half year conference call to discuss the financial results. I would like first to start by highlighting some executive changes in the company and introduce the management team who are here with me this afternoon.

Patrick Nyaga, our former Chief Finance Officer, left the bank one month ago to join the CIC Insurance Group as the Group Chief Executive Officer. As you are aware the CIC is an associate company of Co-operative Bank Group where the bank owns 24.8% of the shareholding. And it is our expectation with Patrick's enormous experience he will be able to push the group's results. The company has not been performing very well in the last one year but Patrick has been given that duty by the board to push performance and lift the performance of the company. Caroline Karimi has replaced Patrick Nyaga as the CFO. Caroline Karimi has been with the bank for the last over seven years. Initially she was Head Business Performance in Finance and Strategy division.

We also have Anthony Mburu who has moved to special project under the CEO's office. Right now, as you are aware, Co-op Bank is in the final stages of acquiring Jamii Bora Bank and Anthony Mburu, previously Director Credit Management division has taken that role to finalise the acquisition. So in place of Anthony Mburu we have Mr Arthur Muchangi who has taken over as Director Credit Management division. Arthur has been with the bank for quite some time, over 15 years. He has been Director Retail banking. He has also been in various sections in the bank, corporate banking, retail banking and finally Group Chief Risk Officer.

I have taken over from Arthur as the Chief Risk Officer and my position which I was doing before, Head of Investor Relations and Strategy, has been taken over by Miss Veronica Njore who was also working in that department, Investor Relations and Strategy. So basically, those are the changes we have had in the group. And, again, to introduce the team which is here with me today. I have Miss Caroline Karimi. I have Mr Arthur Muchangi. I have Mr Anthony Muli who is the bank Economist. I have Mr Robert Aloo, our bank Treasurer and Miss Veronica, the incoming Head of Investor Relations and Strategy. And I also have Mr Sam Oyugi who is the Head of Portfolio Management in the bank.
Last week we did share with you our half year performance results. I hope you have had some time to go through them in preparation for this investor presentation. We'll start with Anthony Muli who will take us

through the macro highlights. And then after that Caroline Karimi will take us through the other financials. And from there we'll have our session where we can have your questions and we can answer the questions. Thank you very much. Again, I take this chance to welcome Anthony to take us through the macroeconomic highlights.

Anthony Muli
Okay, thank you, James. Good day everyone. First I will give a brief summary or highlight what you're seeing on the macro space. Obviously, most of you are aware that the GDP Q2 numbers are not yet out officially until the end of September. Our performance in Q1, shows that the country did a good run in terms of growth. GDP is at 4.9%. Most of it was in agriculture at 4.9%, services at 5.5%, and the industry at 4.4%. However subsequently after the Q1, the pandemic hit us and what you've seen is a depressed Q2. However, looking at the June numbers it's been a bit of this depression getting off. Obviously we still have trouble around recovery in tourism, hotels, transport, real estate, private education and a bit of health.

Looking at the numbers for May and June sort of the high frequency economic activity numbers. We seem to have seen a recovery. Looking at most of the exports from agriculture, for example, flower exports; they are up about 23% from their lower levels in April. Fresh vegetable exports are about 18% up, Coffee about 2% up compared to the first half of 2019, Re- exports are also up by about 19%, Tea production was up about 41%. However, tea price in the first half of 2020 compared to 2019 was down to about \$1.86 a kilo from \$2.16 realised in a similar period last year.

So looking at the second half of the year, we see a mixed outlook. Some sectors will recover, whereas others will stay depressed, especially in tourism, private education, and a bit of travel. The KES has been broadly stable over the months until mid-July when we saw some depreciation. This arose because there was a mismatch in that period and even up to date on the inflows. That's the demand and supply of the dollar. On the interest rate market, we've seen quite good stability in Q1 and Q2. Short end yields have fallen in Q2. We are now looking at an interbank rate of about 1.8% down from about 6.5% in April. This has been driven by huge liquidity within the bonds and some of the fund managers.

On inflation we've seen it consistently falling from about 6.0% in April all the way to 4.4% in July. This has been driven by favourable weather. We've recently seen a drop in maize prices per bag from about KSh 3,200 per bag in May to KSh 2,800 per bag in August. So that has really helped a lot and also the fact that the Rift Valley has started harvesting maize in the month of July and August. Looking ahead into the Q3, unless we see any surprising from oil prices, inflation should be well within the range of targets by the government. On private sector credit we saw a good run all the way through March. However, given the COVID situation and certainly the deterioration of the macro environment, banks have pulled out much of their risk taking and we should still close the next two quarters at sub 10% in terms of credit growth. With that I'll invite Caroline Karimi to give us the financial performance. Thank you.

Caroline Karimi
Thank you, Anthony. This is Caroline and I'm happy to take you through the financial highlights. I'll quickly skim through the strategic forecast, just appreciating the content that is there. And on our first slide, which is slide 10, we continue with our strategic focus mainly hinged on our main stakeholders who are our shareholders, customers, our staff, the enterprise and the community. Co-operative Bank of Kenya's group structure, nothing much has changed. So we continue having our subsidiaries and our different companies as we have seen previously. And we continue to drive a successful investor model.

We start off with Cooperatives where we have a good book of about KSh 27.7 billion, Retail and business banking, which is a huge area for us at around KSh 161.5 billion. Then in the corporate Government and institutional banking, a loan Book of KSh 102.2 Billion, we are offering Leasing, stock brokerage, insurance, consultancy and capacity building for mostly our Saccos, and fund management, where we continue driving fund management of about KSh 120 billion. Our presence continues marked by a footprint of 159 branches, 584 ATM, our growing customer base of 8.8 million and out of these, we note 5 million are already on our MCo-op Cash, our mobile banking solution. Therefore, they are driving that line. We also have the Coop kwa Jirani agents with over 17,000 agents, internet banking customers who continue to grow. We also have 479 Sacco Front Office Branch networks that enlarge our foot print further, as well as Diaspora banking, our contact centre and our 4497 staff.

The next item is on the acquisition of the Jamii Bora Bank Ltd. And we note that the shareholders of Jamii Bora Bank have had an extraordinary AGM. That was on 1st of July and approved the Co-op Bank offer to acquire 90% of Jamii Bora. So to this end we are investing KSh 1 billion into the business and also appoint a board to run the business. So this has been gazetted by notice number 5475 of August, 5th, 2020 in case you'd like more details. The acquisition is effective August 21st 2020. Note that Jamii Bora is a fully fledged commercial bank and it's licensed and has been regulated by the Central Bank of Kenya. It has 444,000 customers and 17 branches. And these are resources that we bring on board and help with our performance. The acquisition also offers us an opportunity cross sell and to deepen our product offering by creating a niche Bank which will offer specialised credit offering especially in line with MSME banking, micro finance banking, youth and women banking, asset finance and leasing.

We have been on the transformational journey 'the soaring eagle transformation' in a bid to continuously drive growth and efficiency and we continue to drive the key pillars. I will move on to slide number 17. And on that note we continue to champion social economic empowerment and also continue to win awards that is number page 18 for your appreciation. And I will now dive into the financials.

And starting off with the regional business, the Co-operative Bank of South Sudan. We still have the 4 branches in Juba and 5 non oil collection centres and it's through this business that we own 31% of CIC Africa Limited in South Sudan. So from a performance point of view we see a mixed situation, loans and advances declined from KSh 1.7 billion to KSh 1.3 billion mainly given how the economy is. Total assets have gone up from KSh 5 billion to KSh 7 billion. Customer deposits also grew from KSh 2.4 Billion to KSh 3.98 billion and retained earnings, you can see there they also went up. Net interest income declined from KSh 148 million to KSh 100 million. The total operating income also declined a bit from 517 to 481. Operating expenses you see an improvement of about Ksh 45 million from KSh 424 million to KSh 379 million. And finally, we see profit before tax went up about 10 Million mainly contributed by reduced expenses and also a bit of growth on non-interest income.

Moving onto our channels. 91% of our transactions are on alternative channels. And e-credit has continued to be a focus area and we've disbursed 91.1 billion to date. Now in this COVID period we of course note a reduction in transactions owing to the restrictions of movement. We see reduction in merchants, branch channels, Internet, ATM as well and agency Banking but we are happy to note very good growth on MCo-op Cash that has moved from 23 million transactions to 38.9 million. So, this continues to be an area of growth.
From an e-credit perspective our cumulative loans in millions standing at 3.78 million customers, who have borrowed to date, a total MCo-op Cash loan book of 91.1 billion. E-credit is mainly driven by the e-flexi which accounts for 86% of the borrowing, followed by Business e-credit loans at 14%.

This is why we mainly give salary advances. Of course these customers are pre-scored and we always conduct our due diligence in terms of the employers we work with. Then there is business plus category that is driving about 3% and also unsecured business plus that is about 11% of that book. Our mobile banking and I will quickly take you through the transactions grew from 24 to 39 million year on year. Commissions have also grown 1.8 to 2.5 billion year on year. And we see also deposits have also continued growing. So this is a demonstration that it is a key growth area for us and key growth channel.

Agency Banking. the number of agents have gone up considerably. Though we note again, because of the effect we've had on COVID because that began to decline transactions, the fees are suffering moving from 23 million to 18 million. Total revenue also declined from KSh 250 million to KSh 214 million. As well as the deposit we are able to generate from this channel. I will not dwell so much on slide 26, 25, on agency banking. That's an appreciation of the various transaction types and also the transaction value distribution through that channel.

On to the core financial highlights. You'll note a strong financial position from our total assets. We are able to grow our balance sheet from KSh 430 billion to KSh 513.9 billion. Loan book year on year also grew from KSh 257.6 billion to KSh 272.2 billion. We also registered very good growth on our deposits from 325 to 389.8. And we also note the increase in shareholder funds. A little bit more detail on slide number 28 or page 28. Just noting the 2019 full year performance, the Q2 2019 and Q2 2020 for year on year change. Key on these, we've seen assets grow 19.6% , loan book growth of 5.7% growing to KSh 272.2 Billion. Government securities growth where we've been able to drive the additional income for the increased level of deposit of 28.8% and we see deposits have grown 20%. Borrowed funds, a bit of increase there to 19.4% where we've been able to grow on some tranche within that period.

Shareholder funds, these had 12.8% growth and accounts holders continue to grow 8.2 to 8.7 Million, up by 6.6%. Then we're moving on to segmentation of the loan book. We continue to appreciate and see that we have a diversified loan book. Biggest portion or largest portion being the personal banking, having grown year on year from 35.7% to 42.1%. Then corporate 25.7% a decline year on year to 22.6%. And we also note a bit of decline on mortgage from 14.1% to 12.5%. And you can see the others, all the way from asset finance, SME, Micro that has been relatively stable, to agri business, and then Sacco Banking from 7.7% to 8.2%.

Again from a sector point of view on the diversified loan book year on year, between Q2 2020 and Q2 2019. Out of our book Tourism, restaurant and hotels represent only about 1%. Personal consumer and a bit of household grew from 41% to 45%. Real Estate declined from 12% to 10%. Financial services, and these are the ones that covers mostly our Saccos, a bit of insurance also grew by 1% from 10% to 11%. Transport and communication grew by 1% from 9% to 10%. Trade declined from 15% to 12%. Building and construction has remained stable at 2%. Energy and water also remains stable at 5%. Manufacturing, you'll see a slight decrease of 1%, it's a small dip you see a slight decrease from 3% to 2%. And agriculture was also relatively stable.

Again, on appreciation of the liability portfolio. And you see the key segments, the larger portfolio are institutional banking, and also retail, but also the others contributing quite a sizeable share that is SME and government banking. The deposit distribution from another point of view, we continue to hold a large chunk of our liabilities in current account at that 36.4%. Transaction accounts 26.6%. Funds on call deposit 14.3%. Fixed deposits were at 17.8% we've been seeing the fixed deposit numbers going down and also actually contributes to the lower cost of fund. Savings 4.9%. On slide 32 or page 32 we see that we are optimally balanced from a Kenyan Shilling point of view, both from assets and also funding book. Starting at the KSh funding of 89%. And also the loan book just about the same at 89%.

And the quality of the loan book using our prudential standards, 80% of our book at the end of June 2020 was at the normal, KSh 232.6 billion. This is compared to a similar period where we had about 78% or KSh 214.2 billion. Watch has declined a bit year on year from KSh 30.38 to KSh 25.357 that is 9% of our loan book. Substandard, this category went up from KSh 11 billion to about KSh 14.9 billion. Doubtful has slightly decreased from KSh 18.1 billion to KSh 17.8 billion. And a slight decline under loss from KSh 637 million to KSh 571 million. So from gross loans as you see we have moved from KSh 274.6 million to KSh 291 billion, with provisions moving from 18.8 to 20.5. And gross non performing loans also growing from 29.9 billion to 33.4 billion.
From an IFRS 9 perspective, we see how we have staged our book. Stage one, that's KSh 232.61 billion and have provided KSh 5.24 billion against that book. Stage two KSh 25.36 billion and we have provided KSh 1.93 billion. Stage three at KSh 33.42 billion and have provided at KSh13.42 billion.

Moving on to page 35 where we are looking at the specific sector NPL by sector book. You notice the highest NPL proportion at any of these sectors is at the manufacturing having gone up from 47% to 72%. We also see manufacturing sector book is small compared to our total book. Then building and construction is moved from 19% to 50%. Trade, 24% to 33%. The others are not major movements; some of them have just remained the same. Manufacturing you see a big jump, and this may be an impact of maybe one customer but again to say it's a small book. But generally, we do not have any big ticket names under the restructures for COVID and most of the ones affected are smaller names. And even looking at the total number of the restructures we've done viz a viz what we are seeing is a bit high at 12329 cases meaning we've had a lot of customer contact and restructures, only that the loan amounts are not as big. So far no big ticket items.

Going on to page 36 total NPL by total bank NPL book Trade has the highest having moved 33% to 36%. Personal Consumer declined from 19% to 17% because the book has also been growing quite a bit. And manufacturing has moved on by 1% from 14% to 15%. Financial services, there was a decline from 10% to 8%. And the others we looked at have remained relatively stable. On cost of risk, 2019 we had 0.9% and this has grown in Q2 2020 to 1.4%. We continue observing our book and what is happening to define or see what direction the cost of risk is takes. Coverage CBK, this one includes general provisions. We've grown this coverage from 61.6% to 66.2%. IFRS coverage, which excludes general provisions we've seen a slight decline from 61.6% to 60%. We continue to have strong capital to support our growth. And you note we are way above the regulator requirement with enough headroom. From core capital to total assets we have grown from 16% to 16.3% against the requirement of 10.5%. Total capital over total risk weighted assets we've also grown 16.3% to 16.8% against a requirement of 14.5%. Declined on core capital over total deposit liability mainly because of the huge growth in deposit as of this year from 19.3% to 18.2% against the requirement of 10.5%.

On page 39 we appreciate that we have an optimal asset and funding mix and see the asset category movement year-on-year. And we see net loans have moved from 60% to 53%. We have an increase in government securities as well cash-and-cash equivalent which we also continued to invest as opportunities came up to shore up our interest income. On funding categories customer deposit has remained relatively the same in terms of proportion at 76%. A slight decline on shareholder funds but relatively that list has remained almost the same. We have strong liquidity to support investments and we close Q2 2020 at 54%, compared to the same period last year which was 45%. Loan to deposit ratio declined from 79.2% to 69.8% meaning that with growth opportunity the loans will have room to grow. Loan to deposit and borrowed funds this declined a bit from 74.3% to 65.5%.

From our group point of view on page 41 you will note our subsidiaries contribution and see among them, even though the main bank the Co-operative Bank of Kenya had a declined profit before tax by 8%, we note the Coop Consultancy and insurance agency grew by 10% from KSh353 million to KSh387 million. Co-op Trust Investment

Limited also grew 24% from KSh38 million to KSh47 million. Kingdom Securities deteriorated into a loss position, this was from a KSh1.4 million last year to KSh14.1 million and the main reason being the lack of activity at our stock exchange and a few of other operational issues which we are continuing to work on so we expect increased performance this side.

Co-operative Bank of Sudan registered an 11% growth so we see that total profit before any eliminations on the group company we declined 7%. Our share of profit from associates CIC and Coopfleet Africa was a negative 53.87 million. We moved from KSh 26.7 million profit position last year to a bit of loss of KSh 53.876 Q2 this year. The group profit therefore declined 8%. And the group profit after tax declined by 4% owing to the reduction in taxes and also the reduction in profit. Sustainable profitability growth, note the key highlights there from comprehensive income statement most of the lines went up, interest income went up 6.8% but also note the loans also grew. Interest expense, there was an improvement in terms of the cost from KSh 6.17 Billion to KSh 5.9 Billion. We note even though we grew our deposit book, the group cost management initiatives helped to keep this cost down and also supported by the environment where we have consistencies in the Central Bank rate coming down.

Net interest income went up 11.6%. Fees and commission income we see a decline of 4.4%. And as already seen on the channels we note a bit of reduction in our transactions because of the restrictions. But as the quarter moved on the worst hit month was April, We've noted increase activity as time moves on. Foreign income, there was very good growth of 37.2%. And other income there was some decline from KSh 0.72 billion to KSh 0.24 billion. Loan loss provision we did 57% increase year on year. We note that there's a growth of 15.5% on staff cost compared to last year but has been coming down year on year and we expect that to continue through the year. Just going through some of the other key items I think we've covered most of them. Profit after tax we have a 3.6% decline. Then we analyse the earnings per share went down from KSh 2.55 billion to KSh 2.45 billion.

As you know the key ratios return on average assets, owing to the reduction in profitability, these rates, some of them went down from 3.6% to 3.1% for return on average assets. Return on average equity also went down from 21.5% to 19.1%. Earnings per share have gone from 2.55 to 2.45. The net interest margin moved up. The key contributor to this was the reduction in the cost of funds. And the cost income ratio without provisions, we see that moved from 49.6% to 52.4% and with provisions from 54.8% to 60.1%. Net interest margin on loans moved from 7.8% to 8.2%. Other key ratios are non-funded to total income from 38% to 34%. Transactions based and non-funded income that we would ordinarily get from the growth of loan book was impacted. Non-performing loans moved from 10% to 10.5% but this is where we see industry average. Cost of average funds including borrowed funds this moved from 3.7% to 3.1% and this was a remarkable improvement. Debt to equity moved up about 2 percentage points from 30% to 32%. I hand over to James Kaburu to take us through the questions.

James Kaburu
Thanks once again, Carol and Anthony, for that presentation. We now open the floor to various questions and answers. Maybe the way we do it is we can take about three questions at a time, either from one individual or three of them. Then we can answer before going to another one. I hand over to the speaker.

Operator
Thank you very much. Ladies and gentlemen at this time if you'd like to ask a question, you're welcome to press * and then 1 on your touchtone phone or the keypad on your screen. At which time you will hear a confirmation tone, following this process will place you in the question queue. If you decide your question has been

addressed and you wish to withdraw your question, you're welcome to press * then 2 on your touchtone phone to remove yourself from the question queue. Just a reminder, benefit all the participants that have joined via the HD web phone, please ensure that you have given your microphone permission to make yourself audible before accessing the question queue. Ladies and gentlemen, just a reminder, if you'd like to ask a question, you're welcome to press * and then 1. The first question comes from Adesoji Solanke of Renaissance Capital.

Adesoji Solanke
Thanks James, thank you for the conference call. This is Soji from Rencap. I have quite a couple of questions. The first is with respect to deposit growth year to date, it's been quite strong. How sustainable do you think this is and what is the outlook for loans and deposit growth for the rest of the year? My second question is on cost of risk, your number is at 1.3% and as you would know it is significantly lower than your peers who are somewhere around 4%. I'm just trying to understand why you think this is the case and do you expect to remain at these levels this year and next year.

Then on slide 29 and 30, what's the difference between what you call personal banking and personal consumer? Whichever the case, you have about 42% to 45% of your loan book in personal lending. Can you speak to the makeup of this? What's the split between lending, corporative, mobile lending and others within, what you call, personal? Then just a few more questions. You've restructured about 13% of the loan book. I'm just wondering why haven't you raised more portfolio provisions on this similar to the magnitude we've seen at some of your peers? Then also just in terms of tax rates and dividends, do you have any guidance for us for the rest of this year? Just finally on cost, so your staff costs were up 10% quarter on quarter, can you talk us through the drivers behind these and the room for cost savings and how you see overall costs playing out for the remainder of the year? Thank you.

James Kaburu
The question on deposit will be answered by our Treasurer, then the one on loan outlook will be answered by our Director Credit Management, Caroline will take cost of risk together with staff cost and the question on tax and dividends.

Robert Aloo
Thank you very much for that question on deposit. I think just in general the market has been very liquid this second quarter so we have also benefitted from reimbursements from government but also as an enterprise we have targeted to reduce cost of funds with these particular actions. If you looked at our growth that we have also put across, most of it is happening in transactional account and current account. I think we will remain with our guidance in terms of having growth of deposits at about 15% until the end of the year and if we sustain that I think it will definitely be a success in these times, even the other outlooks are fairly muted. Just also to point out that we have had success as you have seen in terms of our collection through the MCoop cash portal so we are getting a lot of deposits through our digital channels and that is sustaining our success in terms of deposit growth in this particular period. I think we may not continue that high growth rate but I think it will of course remain in double digits as we go towards the end of the year. Thank you very much.

James Kaburu
Thank you Robert, then I'll hand over to Carol so that you can answer the other two questions.

Caroline Karimi
I'll take on the first question on cost of risk that we've seen has grown since last year to about 1.4%. Going forward of course we are reviewing the restructures you're doing and the state of our books as we move on so

naturally we would expect some slight increase. Right now, I'm not about to give the exact figure on our outlook but we are looking at anything up to about 1.8%, 2% but that is provisionary as we see the book to date. On the issue of staff costs, yes they have grown compared to last year but we've held back hiring and for any attrition we are not doing any replacements. So we are working with the existing resources to increase the productivity so we expect moving on and even looking on quarter on quarter movement, we expect this to come down.

And also other areas of expenses, of course with the working from home, new way of working, a lot of the expenses naturally sort of fall off, especially on the discretionary side, this would be areas of travel and accommodation, that has reduced substantially. A lot of the office expenses has also fallen off, there's not much printing and such like related costs going on right now. Also, we are reviewing other areas like for example, our workplaces and the rent we pay and the spaces we occupy just to see how we can optimize this going forward. So in the medium this is an area we will be looking to drive cost saving. I hope that I have answered your question adequately.

Adesoji Solanke
My question is actually, so if you look at your cost structure, excluding staff costs those numbers are actually up quarter on quarter and year on year, so your explanation doesn't actually tally with what I'm seeing in the numbers, so that is the first thing. Then I didn't get any response to the question on loan growth guidance and all the other questions, can you spend some time on those please?

James Kaburu
Okay on the loan growth we are coming there let me hand over to Carol on the question on cost again.

Caroline Karimi
If I heard you right you are asking other than staff costs the other costs have gone up. And the explanation to that would be ordinarily on any year there is an inflationary adjustment that would happen on that cost as security and many other costs. If expenses increase that has to be passed on to the company, so even what you buy, materials, you'll find that most of these items they are adjusted with inflationary adjustments. So I think that is one and the increase that you have seen in some of these areas is mainly driven by that. But not to say going to the next half of the year, of course, we're on a lookout, not to say probably the unit cost of those items but also look at how usage can go down as we try and drive and manage any discretionary expenditure that is likely to come up. So that is an area on our focus and an area that we are working out to ensure that it does not grow more than where you have seen it at half year.

James Kaburu
Soji the other question you had was on tax. Tax this year we are working on 25% because there's that window which has been given by the Government. We don't expect it to be changed within the year. Going forward, we may not know about next year, but our working this year is on 25% corporate tax.

The other question is on dividends. That one at the moment we may not be able to give you the right figure because of course the profitability is a bit muted and we expect a slight decline but of course still we wish and definitely we are going to close the year with profitability. We still may end up paying dividends. On what we may end up paying, I may not be able to tell you at this time. I think we'll continue discussing this. But one thing I also want to highlight is we've just had a guidance from our regulator CBK the other day, where they are requesting banks to revise their Internal Capital Adequacy Assessment Process and they are saying, for example, if a bank has to pay dividends this year, they're required to have a board approval and also an approval from Central Bank on what kind of dividends they are anticipating to pay. So that's a new requirement they want a revised the policy based on the current pandemic, this has a deadline of October, 31st 2020. So even as any bank plans to pay dividends this year, there's a requirement for justification of what is being paid as dividends. Again, the figure, this we'll continue talking, at the moment we cannot tell you what will be done. I'll hand over to Arthur to answer your other question on breakdown of personal and the consumer banking as well as provisions.

Arthur Muchangi
Thank you very much James and thank you for the questions that have come through. I'll attempt to answer them, maybe not in the order in which you asked them but based on how they come. The first question was around personal loans, personal banking and personal consumer loans. I think those customers they were slide number 29 and 30. The distinction we had between the two slides is that on page 29, we are talking of our internal segmentation of our book. So some of it we see to be retail, some of it we're going to personal consumers, some of it will sit within our cooperatives and the balance within corporate. So from a segment perspective, what you are seeing here is personal banking.

Now when we cross reference to the next page, page 30, here we're talking of the same information but from an economic sector perspective. So it's the same, same information, one based on our internal classification and the other one from our economic sector classification, as graded by our Central Bank of Kenya guidelines, broad guidelines on segmentation. Now, if we're speaking slightly more into that particular point, you raised the comment that it constitutes almost 45% of the economic sector, that is factual and that indeed is very, very true. You will notice that almost 50%, 45% and 50% of our book is sitting with that consumer space.

Now to add more illumination to that point and then also to say, these are the typical and unsecured loans that are given to employees who work in the country. To add on to that, I want to say that a big chunk of that, almost 80% of those are unsecured loans, we tend to favour the government of Kenya employees, government parastatals and quasi-government bodies. Suffice to note here that those particular bodies, being government owned have generally weathered the storm much better in terms of the employees are still in employment, there are no salary cuts and they are not looking into job cuts, you don't see the government really taking any drastic measure on its workforce.

so we think that we are very stable in the book, we think It is a book which we shall continue nurturing and indeed it's an area we focused on.

The next question about the outlook, I think we'd all agree that these are difficult times for any financial institution and so perhaps the more bullish way most institutions had before covid would have to be a bit muted. We still see pockets of opportunity into the future in line the economic activities as they struggle to resuscitate, to start, kick start it.

So for starters, we see quite a bit of opportunity in the health care space, medical equipment and literally anything to do with the supplies in the medical space is an area which has a lot of opportunity and we think we shall focus there for the time being. Agri business is also an area we think we can put more focus on. I think in the economic presentation, Anthony was presenting, his first slide did talk of some sectors showing early signs of revival or recovery and so we want to back that by focusing a bit on agri and related.

Last but not least, we also want to mention, just in relation to your earlier comment about consumer, we still see that as a growth area. We still see that as an area which we shall continue putting our focus on the segment as it has been able to shore us through a period of time. I think there's special mention here for what we call our digital loans. The space for the mobile based loans, they have been a growth area for quite a while now. Pushing our transactions through the channels is a growth area.

And so that's what we are seeing much, much more and focus on into the future. Your last comment, your last query rather, sorry, was more on what our peers, vis-à-vis ourselves, have done regarding provisions. I can perhaps comment on the figures that we have published the way they are looking. I think the first comment or the first comment on that will be generally, for once appreciate that if we have almost 45% heading 50% of our book on a sector which is largely not impacted by the effects of COVID, then we may not necessarily have to do anything much.

That is a sector which is still paying, the people are still in employment, the payrolls are still being processed and so to that extent then we've not really had that much effect on that book, built. Almost 80, 90% is within government related workers and so to that extent then we may not have much effect. The other way to look at our performance and provisions is just to ask ourselves about the overall loan book growth over time. We have not been very, very bullish in the course of the last year or so, especially around corporates and SMEs. That then has perhaps shielded us from taking on additional debt in those segments which are now, from what we see in the economy, are now turning to be problematic.

So I think our choice to stick more to the consumer side could have helped us by not getting the bigger corporate, who are not getting the bigger hit. So by sector, I think that has come to our assistance. I think it's also to be mentioned that we see a bit of lag effects, we are alive to that. COVID restructures, the onset of COVID in Kenya was just around mid-March this year. So the full impact of the restructure is really into Q2 and from what we have seen either from our figures maybe we will not have risk, is to say that in Q1 indeed we had a few items or a few accounts which got into distress and put in about KHs 6 billion, but you'll notice that we've taken steep shift on restructures to KSh 39 billion in Q2.

That's almost a KSh 33 billion increase because of that lag effect between Q1 and Q2. But having said that then, we are starting to see a slowdown and we don't really think having reviewed our book over the last few months whether we have any more surprises along the way. So if we have to need to get any additional re-structures and or provisions they are not going to be as strict as what we possibly have put in out there. So maybe just to mention that we have taken the deliberate policy of not restructuring on a sector-to-sector basis, but to a name-to-name basis which then we address the particular customer and the specific need which therefore has informed the level of provisions that we've been able to put in.

So in the course of the customer's regularly engagement, we're able to tell what the needs are and therefore also be able to put in the relevant reliefs that will reach our customer and therefore that informs part of the performance that we have published today. Thank you very much. I trust I've been able to address some of the questions that have come up in that space, thank you.

James Kaburu
Okay, thank you, thank you Arthur, we can then go to the next question.

Operator
Thank you. The next question comes from Timothy Wambu of Absa.

Timothy Wambu

Thank you very much for having the call. I just wanted to follow up on some of the questions that you've answered and really it's about the risk that sits in your personal loans portfolio. So you mentioned it's about 45% of your loan book and you're telling us that a lot of these loans are to government related entities. Could you give us a split of what is government and what is private sector? I think that would be very useful as we look at this particular sector, because if you look at CBK data it shows that this is the most affected sector which has had the most amount of loans restructured. I think that would be a good starting point. And just on that, maybe just give us a split of the KSh 35 billion into sectors so that we get a sense of where you have the most exposure. And then just lastly looking at slide 33 I just want to know how you calculate your NPL ratio. From that slide it looks like it's somewhere close to 11.6% but you're giving a different figure of 10.5%. Thank you.

Arthur Muchangi
Okay. Thank you Timothy. I didn't get your second question but I'll attempt the ones I got clearly about the risk in our personal loan book. I think your concern was around whether it's sitting purely on government sector and public sector. I'm not too sure there is a very thick line dividing public sector and government sector, Timothy.

Timothy Wambu
Sorry, my question was the split between government-related entities and private sector in your personal loans portfolio. That's the first question. The second question was if you can give us a split of the KSh 35 billion to the various sectors that you've had to restructure.

Arthur Muchangi
Okay. Thank you. I think government related entities is well over 80% of the personal loan book and just shy of 20% is private sector workers. As I've mentioned earlier, even those private sector workers we also have much more rigorous terms to qualify for those particular facilities. So when you look at overall the people impacted in the private sector you don't have too heavy a number because our criteria tends to see them move early before their credit goes onto our books. so to that extent Timothy we are in that kind of space. Having also said that it's important to mention that when you talk of government sector it's important to note that this sector is very widely distributed.

We are talking of teachers. We are talking of disciplined forces. We are talking of civil servants. We are talking of soldiers. We are talking of employees within the central government. And we are talking of people in what we call parastatals and quasi-government bodies. So it is very well distributed. A very healthy distribution such that we do not see a systemic risk in any particular subsector or sub employment category because of the wide distribution. To that extent, Timothy, we have been able to hedge by virtue of wide distribution of customers that borrow from us. To your second question about the KSh 39 million that we restructured I think I'll ask my colleague James Kaburu to say a word or two.

James Kaburu
Timothy, the one thing I also wanted to comment on our personal loan book, you realise in terms of the way we do our presentation we not only appraise the employee but also we appraise the employer. For example like you have talked about government entities. We have talked about the teachers. Then when you come to the private sector we are also appraising the employer. You will find in the areas where we have the challenges in the private sector we will not lend to employees in those areas. These are areas like hospitality industry and lending in terms of manufacturing. So in terms of private sector you find a lot of it in SACCO borrowing who are repaying and they have not been affected as much.

Arthur Muchangi

Thank you James. Timothy, to your second question about distribution of the KSh 39 billion, I think suffice to mention in percentage terms that the biggest restructures have come from sectors which are homogenous in the sense that when we look at the industry data provided by CBK our data is also following similar trends on restructure. So we know that sectors like real estate have had a bit of challenge. We are aware of transport especially when there were lockdown and movement restrictions. Transport took a hit. The small, micro and medium enterprises and SME, especially traders. We saw a slowdown in that sector for quite a number of months. And so those are the particular sectors which have given us a bit of trouble and therefore needed to be restructured. Cumulatively those are coming to give or take 60% of the split, and the rest is other smaller sectors like manufacturing, agriculture, a few cases here and there in personal consumer and one or two cases on tourism. But suffice to mention 60% and largely following the trend that you have also seen from data from the regulator.

Timothy Wambu
Thank you.

Caroline Karimi
So how we've arrived at the net NPL, the 10.5%, I assume that's the figure you're looking at. The non-performing loans and advances net of interest in suspense, that over our net loan book. So the figure essentially then would be something like KSh 28.65 billion over KSh 272 billion which is our net loan book.

Timothy Wambu
All right. Thank you.

James Kaburu
Okay, we can take the next question.

Operator
Thank you. The next question comes from Ronak Gadhia of EFG Hermes.

Ronak Gadhia
Good afternoon team. I hope you can hear me.

James Kaburu
Hi Ronak. Yes, we can hear you.

Ronak Gadhia
Hi James and team. Thanks for the time and taking the questions as always. Three or four questions. Firstly could you comment on margins and within that what I mean is has your risk pricing model been approved by the central bank? And if it hasn't been, what's the hold up? And subsequent to that once the model is approved what is your outlook for margins in the medium term? We know the short term there's not much scope for raising rates given the environment, but is the medium-term outlook still intact? Second question. As always, Arthur, you will appreciate me asking what the status is of your legacy NPLs. There is a big manufacturing loan and I think two or three large real estate loans. We were expecting some recoveries this year, but in this environment that's not going to happen. So is the recovery of those loans still viable, and if not shouldn't you be making more provisions on those? And sticking to provisions, could you just share with us some of the macro assumptions that you have made in coming up with your ECL assumptions for this year and for next year? And finally, on your fee income what trend should we expect through the rest of the year? We saw a pretty big drop

in the second quarter understandably, but what should we expect through the rest of the year and potentially into 2021? Thank you.

James Kaburu
Thank you Ronak. I will give our Director of Credit the first three questions to answer. The first is the risk model. Sam will assist in terms of the model assumptions for ECL. Then Caroline will come up with the final question on fee income and the expectations for fee income.

Arthur Muchangi
Thank you James and thank you Ronak for those questions. Let me take the one of risk pricing model. It is good to note that we are one of the first banks in the country to have come up with a proposal on how to have a risk pricing model. Between last year and to date we have made quite comprehensive elaborate presentations to our regulators and they have come back to us favourably just to get more clarity on our model. But suffice to mention that as recent as last week we had our final meeting with the regulator on this, CBK, and we are working on some clarifications and thereafter present back our clarifications. And we think we are reasonably on course to getting CBK approval once we submit the clarifications. So yes, we have walked the journey. We are almost at the end. And soon we shall be able to get that particular go ahead by the regulator. Now, because of that I would not want to pre-empt the approval that will come from the regulator in terms of the margin that we plan to put. And that's because we want to get closure with the regulator first.

Ronak Gadhia
Understood. But if I could just ask, philosophically we were expecting margins to improve when the rate caps were repealed last year. Since then we've seen interest rates come down even further because the central bank has reduced the monetary policy rate. And even structurally we're seeing yields on government paper decline, on the one year paper, on the longer dated paper. So philosophically are we heading into maybe a lower rate environment which could mean that your margins structurally could not be as high as where they used to be pre rate cap?

Caroline Karimi
I can just take a quick take on that one even as Arthur progresses to the other questions. Yes, you have seen the CBR go down, but what we know is our current book, which has carried on from last year, is still at the rate we were at the time the rates were suspended. So going forward there hasn't been any changes on that book. I know on average we are looking at a range of 13%. We gave a bit of a concession or some benefit to our customers of about 50 basis points for the book we had then. So that hasn't changed. and just to say other than from a signalling impact the two have been detached and we are not pricing our book in line with CBR. So CBR is moving down but that has not affected our old book at all.

Then on the issue of government paper coming down, the rates, maybe going forth, again the book we continue to hold is also growing so in terms of margins we would want to see a place whereby we end up maintaining our margins, and maybe very a very marginal decline if the government paper rates really go down. But for now our rates are within our expectations and within range. And in terms of the new pricing model I'm sure once it's approved you may see different pricing especially from a risk pricing perspective where you will find some books going up as we assess customers on a customer to customer basis, and maybe others lower. Generally, we will wait to see in terms of the penetration into different personal segments just to see how the final aggregate rates look like. I will give it back to others to continue the other questions.

Arthur Muchangi

Thank you Carol. I think on the macroeconomic overlays that have gone into our assumptions I'll ask my colleague Samuel to say a word or two.

Samuel
Now on the macroeconomic assumptions that we've applied on our IFRS 9 model we have revised our GDP forecast and the inflation also. For GDP we did a 2% downwards as opposed to the projections that we had previously.

Arthur Muchangi
Thank you Samuel. Ronak, to your last question about legacy NPLs I think you are right indeed that we have one or two cases in manufacturing. And in fact as James has mentioned in his presentation and Caroline, we are not extremely exposed to the manufacturing sector in our books. Now, specifically to answer the question, some of these manufacturing cases they are spread across several lenders and we then have a joint agreement on how we shall be handling some of these particular cases. So for the one particular case which you are referring to in manufacturing we are in constant engagement among the lenders in that particular case to find an amicable result. If we will not be able to make any adequate progress in the next quarter or so then we may have to take that call on what to do with this particular case. But suffice to mention that for now we have continued to perform. We have some good inflows coming in which are sufficient to at least make some of the repayments that are due. Thank you.

Caroline Karimi
You asked a question on the outlook for commissions going into 2021. I would say we are still in a very fluid environment and we have a lot of moving parts. So depending on how the situation pans out and if the recovery happens faster and we resume activity out there we are likely then to see transactions going up. so in that case all these channels where we have seen a dip most of that dip has has come through in Q2. So we don't expect to be hit too hard by the time we get to the end of the year. Another key component of the fees and commissions would be loan fees. So of course we will go in line with the growth or the new disbursements we take up. Another key hit has been the zero rating of the mobile transfers across platforms. So we've been losing quite a bit there. We've really grown our transactions on MCo-op Cash. But growth is not directly translatable to the income because of that zero rating that was given by the regulator. Again that's a moving part. If that is uplifted we are likely then to go back into some aggressive growth in terms of revenue on that line. All in all, we expect a better closing position than where we are at half year. 2021 even better.

Ronak Gadhia
Understood. Sorry, one final follow-up from me maybe for Arthur and the credit team. We have seen some of your peers indicate that going forward they will be marking down the value of their collateral because we are seeing a correction in the real estate market. Is that something that Co-op is intending to do, i.e. reduce the value of the collateral and therefore pick up provisioning levels?

Arthur Muchangi
Thank you. That's a good question. I think a bit of context there to what we are discussing. number one is to say that is a continuous exercise but in terms of significant haircut I think it is good to go back to some background. If you go back three, four, five years back there was a steep increase in property values in the market. So even if we are to take a particular discount at this particular point you appreciate that the discounted value will not necessarily go to much lower than the value of the debt that we're exposed to. I think what I'm trying to say is that even after discounts we think we have sufficient cover to cover the exposure that we have on our books to a large extent. So yes, it's something ongoing but in our opinion maybe we have sufficient buffer. Thank you.

Ronak Gadhia
Understood. Thank you.

James Kaburu
Thank you Ronak. We can then go to the next question.

Operator
Thank you. Going on to the next question which comes from Henry Kabue of ICEA Lion Asset Management.

Henry Kabue
Hello everyone. Thank you for hosting the conference call. I have a few questions. First I would like to know what drove the 37% increase in forex income for the first half, and what is the outlook for the second half? Secondly, what is the loss of revenue from the zero rated transactions for mobile banking during the second quarter? Thank you.

James Kaburu
Thanks Henry. So that I get you clearly, you are asking a 37% increase in?

Henry Kabue
What drove the 37% increase in forex income during the first half? And what is the outlook for the second half?

James Kaburu
Okay. The next one is loss of revenue on the mobile banking. Okay. Our treasurer will answer you on the first question. Then Carol will take the second question.

Robert Aloo
Thank you very much for the question in terms of forex income. I think you all know that the Shilling has depreciated by about 8% in the last quarter following the pandemic outbreak and also a bit from the decline and subdued performance on the Nairobi Securities Exchange. So we have been able to at least take advantage of that particular 8% decline and make up for it in foreign exchange income. I think the outlook towards the end of the year of course is dependent on volatility. If volatility continues remaining high then we should be able to do double digit growth in terms of foreign exchange income. However it's a dynamic market and it is highly regulated at the moment as you all know. If it tapers off and we have also a lot of stability in terms of currency then we will project growth but not maybe as high as what we saw in Q2. I think key to note also is our flows of funds which came in for COVID support which also sustained some of that income that came through. So it is something that we still look carefully and keenly at, but we don't anticipate the same spike in terms of growth like we had in Q2. We think it will taper off as we head towards the end of the year. Thank you very much.

Caroline Karimi
My quick answer on how much we have lost on mobile banking because of the guidance that has been given by CBK is about 15% or 16% of the mobile revenues or commission.

Henry Kabue
And what are the mobile revenues and commissions, the amount?

Caroline Karimi

I do not have the details with me here. It's something we can follow up with.

Henry Kabue
Okay.

James Kaburu
Henry, what we can do, Veronica is going to send you an email on the actual breakdown of the revenues after this meeting.

Henry Kabue
Thank you.

James Kaburu
Okay. We can take the next question.

Operator
Thank you. Ladies and gentlemen, just a final reminder, if you would like to ask a question you're welcome to press * then 1. The next question comes from Martin Karimi of SIB.

Martin Karimi
Thank you, James and team, for the time and the call. My question is with regards to the loan restructures. Looking at your book and looking at your peers the industry we're looking at 29% as at half year. And Co-op Bank is around 13%. So Arthur mentioned earlier the fact that the majority of your book is on the personal lending. You haven't had that much of a need to restructure most of the debt. Actually his wording was the restructure is mostly on a name to name basis, not sector wise. However, when I look at the rest of your book your exposure on real estate, transport and trade, and what is basically happening on the macro environment my worry is that for lack of a better word you might be surprised down the road. My query is whether your clientele are 'immune' to what is happening to the macro space? Thank you.

James Kaburu
Thank you Martin for that question. Again I'll hand over to Arthur to get back to you on that. Arthur.

Arthur Muchangi
Thank you Martin. I think I will be the first to admit that we are all in the same economic space and so we are not immune to what is going on. It's just to say that we continuously monitor the book and on each particular case we see distress we then take particular individual action on it. Now, I think provisions are a function of many things. Suffice to mention that a significant chunk of the big names that we have in terms of distress have either adequate securities that are tied to them or we have been making some provisions gradually. And so as and when we assess and see how they perform in the coming quarters then we shall take a call on the need for additional provisions and coverage. So indeed that is something that we will be doing and it is something that we are conscious of.

Martin Kirimi
Thank you very much Arthur. With regards to provisions actually my worry is with regards to NPLs because we all know once the loans migrate to NPLs you will have to suspend the interest. So don't you think that the fact that as at half year during that CBK window of restructuring you didn't capture most of them down the road you might see an explosion of NPLs?

Caroline Karimi
Just to confirm, the window has not closed and CBK from March gave a period of one year that we continue to be approached by customers and get into a discussion. It's on a customer to customer basis. And I'm sure because you've quoted a bit on industry if you had to look at number of restructures by organisation you realise we have good numbers, high numbers, meaning our doors are open and we are talking to our customers. So the window has not closed and we continue to assess the book, where it is in light of where the environment is. And we will continue to take necessary action in whatever situation we find ourselves in. Thank you.

James Kaburu
Okay. Thank you Martin.

Martin Kirimi
Thank you very much.

James Kaburu
We can take any other question.

Operator
We do have another question, sir, which comes from Chris Engelbrecht of Investec.

Chris Engelbrecht
Hi team. Thank you for the call. I just want to get a sense of what your target coverage ratio is, and if it's not at the moment where you expected it or want it to be, when will this be achieved? And how often is collateral revalued and when last has this been done, or is this done continuously? And also what kind of a haircut is applied to collateral in your LGD assumptions? Thank you.

James Kaburu
Sorry, I never got the name. Maybe you can repeat the question if you don't mind.

Chris Engelbrecht
Yes. It's Chris from Investec. My first question is what your target coverage ratio is and when this will be achieved if it's not at the target level at the moment. The second one is how often collateral is revalued and when last has this been done, is it is done continuously? And then my third final question is what haircut is applied to collateral in your LGD assumptions?

James Kaburu
Okay Chris. I will give Arthur to answer the questions. In terms of coverage targeted our view in terms of coverage and also looking at our book wherever we have a range of around 55% up to 75% we are comfortable with that range. Even right now we are on around 61%. We are not very worried when that range is over 55% IFRS coverage because when you put the general provision which has an impact in the P&L you end up finding the coverage goes up to 80%. And again most of our property we have as security and then we discount the security. That range of where we are in terms of coverage we are comfortable. Arthur, you can take over the other question.

Arthur Muchangi

Thank you. On the revaluation of collateral, we have three broad categories on which we revalue our collateral. One is definitely a policy in terms of number of years after which a property should be revalued. That is across the board for all customers. All kinds of borrowings which are secured by collateral after about seven years we are required to revalue it. Equally we do an evaluation should there be need by the customer to increase their borrowings. So we normally do it to confirm that we maintain the margins that are required between loan to value. The third instance when we revalue property is again when we are on the other extreme in terms of distress and there is a realisation need. We would then also have a valuation exercise. So broadly speaking those would be the categories. But once in a while we have special categories depending on what we pick in a particular portfolio or a particular area based on what will happen with a particular name. So we do have outlier kind of revaluations. Thank you. Samuel.

Samuel
On haircut we normally use the force sale value of our security, but again on haircut it depends on the type of security that we have, the type of collateral. So on average our haircut is around 15% of the force sale value.

Chris Engelbrecht
Thanks very much.

Operator
Thank you. Ladies and gentlemen, just one final reminder, if you would like to ask a question you're welcome to press * and then 1 on your touchtone phone to place yourself in the question queue. Mr Kaburu, we don't have any further questions on the lines. Do you have any closing comments?

James Kaburu
Yes. Actually we are in partial lockdown. That's also why we wanted to end the conference call. That notwithstanding, if there are any other questions or clarification you can always send us an email through Veronica and we will be more than happy to revert back to you. But otherwise I want to take this opportunity to really thank each and every participant for logging in, for your very good questions. And again we will continue updating you. We know we are in a very tough environment where things are changing by the day. So even as we wait for the Q3 performance if there is any clarification you can just send us an email and we will be ready to answer you. Otherwise thank you very much and have a good evening, good morning for those who are already in morning. Thank you.

Operator
Thank you very much sir. Ladies and gentlemen, that concludes today's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT