Conference Call transcript

27 May 2019

Q1 2019 RESULTS

Operator
Good day ladies and gentlemen and welcome to the Co-operative Bank of Kenya Q1 2019 final results conference call discussion. 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 and good evening ladies and gentlemen, again I want to welcome you for this conference call to discuss the financial results for the bank 2019 Q1. And with me I have Mr Patrick Nyaga, who is our group CFO. I have Mr Robert Aloo, who is the bank Treasurer. I have Mr Ndwiga Kamwangi, who is the Senior Manager at the Credit Management Department. I also have Mr Anthony Muli, who is the bank Economist and myself, James Kaburu, Head of Investor Relations and Strategy. I would now want to hand over to Patrick Nyaga to start off with the call.

Patrick Nyaga
Good day ladies and gentlemen. James has said welcome. It is always our pleasure to discuss our numbers with you and this particular time we are discussing Q1. In terms of the presentation we have some slides that we sent to you. I hope you have them. And to start with we will go to the macroeconomic highlights. I will request our Economist, Mr Anthony Muli, to go through that and then I will come back and give you the rest of the presentation. Thank you very much.

Anthony Muli
Good day ladies and gentlemen. Welcome to this conference call. I will take you briefly through the macro slides. What you have noticed is that in Q1 we had a good run in terms of economic levels. If you look at the weather patterns, the payment system levels and also the numbers on the commodity exports the levels are quite okay. However, the statistical office has not yet released the Q1 GDP numbers. What we have is the full year 2018 numbers which were released in April this year just about a month ago. And the numbers showed that economic growth was up to about 6.3% year on year. That's in real terms. In nominal terms it was about 13%. From these numbers we notice that agriculture did quite well. It actually contributed about 21% to the total GDP growth. This was mostly driven by good weather patterns in Q1, Q2 and also Q4 of 2018.

What we have seen this year is that Q1 was quite okay in terms of weather patterns, and we hope that once the statistical office releases the Q1 numbers agriculture will have performed quite well. then I think to notice from the 2018 GDP number is that there was a bit of a shift in terms of the value in the transport sector from road to rail transport. Construction was slightly lower in the sense of the level of cement consumption and also the spending by the government especially on public buildings. But all in all it was a good year. We are actually looking at an economy of our size expanding about 6.3% which is good news.

Looking at the interest rate environment the money market was relatively stable in Q1 of 2019. The CBR was about 9% from 10% same period in 2018. What this means is that our lending rates were down to about 13% from 14% in the comparable period a year ago. So we actually earned less on the lending platform. Interbank was quite stable. We saw small spikes here and there mostly driven by the tax payments and also debt maturity repayments. So overall the yield curve shifted inwards slightly mostly driven by the high liquidity in the system.

Looking at the inflation numbers, our [unclear] this year, especially looking at Q3 and Q4, is on the food situation in the sense that the long rains that were expected between April and May delayed in some parts of the country and the distribution of those rains both in space and time was slightly below normal. However, we haven't seen the latest update from the meteorological department to gauge the level of distribution of that rainfall.

And the Kenya Shilling stayed quite stable in Q1 compared to last year, and most of this trend is actually driven by the fact that we've seen quite a good inflow of agricultural tea and coffee export earnings and also diaspora remittances. This has helped cushion the import bill which has also not grown as much. We saw for example, in 2018 imports grow by about 2% year on year. So that means that the pressure on the Dollar demand was quite subdued. Looking at the remainder of this year we don't see this changing significantly. However, the rainfall season will also drive this in the sense that we might see a fall in tea, vegetable and also coffee export earnings which will mean reduced inflows.

On the private sector credit on slide six I think most banks are still generally not really upbeat in terms of credit risk premium writing. So we have seen the level of private sector credit growth still remain below 5%. The latest number for March 2019 is a growth of about 4.3%. However, this is high compared to 2.4% in December and about 2.1% in the same period last year.

On South Sudan generally the environment has improved compared to last year. We have seen inflation levels now being projected to come down to about 25% from a high of 84% in 2018. And I think key to notice is the key driver of this inflation is about uncontrolled growth in the monetary base system. So if that is controlled then most of this inflationary pressure will remain controlled below 25% this year. The government also opened up some new oil fields and we've seen them getting to an agreement with Sudan on a Bill on the oil transit fees. So we are hoping now that Basheer is out of office then this Bill will launch. But South Sudan is expected to improve in terms of the economic environment.

Anthony Muli
Thank you. I think I will invite Patrick Nyaga to give us the next few slides.

Patrick Nyaga
Thank you very much Anthony. In terms of strategic focus, as you know we continue driving our universal banking model and currently we are in South Sudan and Kenya where we have a total balance sheet size of about KSh 425 billion. I think strategically we don't plan currently in 2019 to enter any other regional markets other than a focus on Ethiopia. So we won't be going to Uganda, Rwanda or Tanzania for now in 2019. However, we are focussing quite a bit on Ethiopia and doing some trade finance business and also considering how we can monitor that market from a closer range, maybe an office in Ethiopia. But in terms of other regional countries we are going for the time being to be in South Sudan and Kenya.

In Kenya what is our focus? We continue driving growth into the various lines of business. And also maybe just to confirm that currently we have no plans to do any acquisition in 2019. So that is not something that is on our radar right now. Our focus currently is to grow all our business lines significantly within the country. And if you look at slide number 13 that's where we are focusing in terms of growing our Retail & Business Banking, currently at KSh 137 billion in terms of loan book, Corporate & Government Banking about KSh 107 billion, Cooperative Banking about KSh 25 billion. Fund management, we've done very well there. We closed the year at KSh 41 billion. We are currently at over KSh 90 billion in funds under management and therefore we expect quite a bit of growth in commissions into 2019. Our insurance brokerage has continued to grow 20% year on year. Our stock brokerage, also our leasing business, so far we have disbursed about KSh 4.1 billion. So far as at Q1 no impact from a P&L perspective has been factored in from the leasing business. That will happen by half year, and therefore we will expect a bit of that to grow there.

So as I said if you look at slide 14 all the way to slide number 22 we are looking at specifically driving some of the strategies that we have in place. And mainly these are focussed on growing customers and business into various areas, be it branch in terms of retail, micro and small and medium enterprises, corporate and institutional banking, cooperative banking. We have also focussed quite a bit on the digital journey where we are trying to implement quite a number of projects including the omni-channel. And these are all meant to grow our business and increase efficiencies.

Other key areas of focus: we will continue with the NPL management. As you know over the last two years the book quality in Kenya has not been very good, so we are clearly focussing there to make sure that we improve the quality of our book. Cost management is very critical, and this is aimed at driving our cost to income ratio which has slightly gone up to make sure that by the year end it goes back to below 50%. Data analytics obviously to make sure that we are able to manage or make decisions based on data. So that is all the way to slide number 22. There are quite a number of details there but I have summarised it.

If I go to our channels on slide 26 we note that on slide 27 our channels have all been growing. Starting with the mobile platform, the MCo-op Cash, we've seen transactions grow from 8.3 million transactions to over 10 million transactions, and agency banking from 10.6 million to 11.253 million transactions. ATMs, you remember at some point last year our ATM transactions were going down. We've done a number of enhancements and services into our ATMs including withdrawing M-PESA, and that has helped in terms of growing our transaction numbers and revenues from ATMs. Internet banking, branch banking a slight growth, and also merchant and POS banking. A key focus has been e-credit as well. That has grown quite significantly and we'll be seeing that in a short while.

Slide number 28 is a representation of that growth in terms of percentage where we are noting that merchant and POS banking has grown 35%. We see that as a key area of growth in terms of commissions this year. And also the mobile platform has grown by 25% mainly driven by e-credit. If you look at slide number 29 our transactions in mobile banking – that's where we are talking about growth from 8 million to 10 million transactions – in terms of commissions that grew from KSh 374 million to KSh 744 million, literally doubling our commissions. And this was mainly because of our focus on e-credit.

If you look at the graph on slide 30 it is very clearly demonstrating that so far we have about 2 million customers cumulatively and so far we have disbursed about KSh 25.7 billion under the platform. If you look at the growth from full year last year to now we've increased the amount of disbursements from KSh 20.1 billion to KSh 25.7 billion, and therefore the source of commissions. Agency banking has continued to grow on slide number 31. ATMs on slide number 32, again we've talked about growth there in terms of number of transactions. Some of these services have just come on board on ATMs and we expect that by the end of 2019 the commission income from ATMs will be much higher than they were in 2018.

I will go to the financial highlights in terms of slide number 33 and 34 noting that we have a very strong financial position. Our total assets grew by KSh 28 billion to KSh 425 billion. Our total deposits grew by KSh 20 billion to KSh 320 billion. Our net loan book declined by about KSh 0.8 million. This is mainly because of what we went through towards the end of last year in terms of pay-offs by some customers, significant customers. However, if you look at the position from end of last year to Q1 2019 we've done about KSh 9 billion of growth in our loan book, so the momentum has started to pick up in Q1 and we expect that by the time we are doing Q2 and Q3 we will have done a significant growth.

In terms of slide number 35 we are looking at the balance sheet itself. I think other than the loan book every other area of the balance sheet has continued to grow. And I have mentioned total assets, total deposits, shareholders' funds and even the number of account holders moving from 7.2 million to 8.2 million. In terms of loan book I think from that graph you can clearly see that our loan book has been growing in two areas, mainly personal banking and SME. The other areas have remained largely flat or a slight decline. Slide number 37 is just showing us where we have lent and looking at personal consumer loans being the most significant part of our book. In terms of liability on slide number 38 we are looking at retail banking being the biggest contributor of our liability portfolio at about 23% and institutional banking, which is mainly NGOs and various other institutions, at 23% as well.

We continue driving a relatively well-balanced balance sheet from a foreign exchange perspective. That is on slide number 39. In terms of quality of the loan book on slide number 18 we haven't seen a very significant movement in terms of this book. And this is why I was noting if you look at total gross loans as at Q1 2018 we were at KSh 266 billion. Obviously after repayments we went down to KSh 259.6 billion. But if you compare full year 2018 at KSh 259.6 billion to Q1 2019, three months later, our book is now KSh 268.2 billion which is a growth of at least KSh 9 billion. So we expect to grow with that momentum throughout the year and we therefore have grown our book significantly.

On slide number 41 just looking at portfolio trends in terms of specific sector NPL by sector book, we note that manufacturing is still the highest contributor of NPL per sector. However, when you come to slide number 42 manufacturing is only 14% of our book. Most of the bigger book is trade which is at about 32%. And looking at the NPL by sector trade accounts for about 23% NPL per sector. So again noting that even though manufacturing is quite high up there in terms of the book it only accounts for 14%.

I will go to the coverage which is on slide 43. Cost of risk at 0.8%, whereas last year it was at 1.2%. And again this is mainly because of some of the things that we did in 2018 full year. There was a lot of clean-up through IFRS 9 and therefore quite a bit of provisions went through IFRS 9 through results. Coverage per CBK is at 62.8%, quite a big jump from 53.6%. However, if you look at the IFRS coverage which excludes general provisions we are at 52.2% compared to 30.6% which is a significant improvement as well. Strong capital to support future growth. Just a comment there that we are well capitalised and we have enough buffers on all our capital ratios, other than for total capital which is probably 1.4% above buffer. We will continue reserving our earnings even as we pay good dividend, and therefore that ratio will increase.

I will skip slides 45 and 46 because they are straightforward and I will go to slide number 47 where we are trying to demonstrate the contribution by the various subsidiaries. We are noting that all the subsidiaries of the bank contributed positively to the profitability by growing profitability, other than for CIC whose earnings dropped. Our share of earnings dropped by about 72%. So in a nutshell our group profit before tax before CIC was at 5%. However when you factor in CIC we dropped to 4%. But again there are very specific reasons for why CIC went down. We expect that by the end of the year they will have increased their profitability. This was mainly because of some claims that came in.

So looking at the P&L itself and noting that net interest income dropped by 7%. This is mainly because interest income dropped by 3% owing to the fact that when we started the year last year our lending rate was at 14%. By July 2018 it went down to 13%. So there is a bit of impact there, and also the fact that we reduced a bit of our loan book, although now we have geared to grow. Interest expense growth is mainly because of growth of our deposits by over KSh 20 billion. However, if you look at the cost of funds that has slightly improved. Commission income also grew significantly by about 34%. And this is mainly because of the e-credit commissions that we have mentioned earlier. In terms of costs, other operating expenses increased only by 1%, and staff costs by 6% which is normally the annual review, and therefore our profit before tax then is KSh 5.1 billion compared to KSh 4.9 billion.

In terms of the various returns on profitability on slide 49 we are looking at a slight drop on return on average assets from 3.6% to 3.5%, return on average equity at about 20.5% compared to 20.9% same period last year. NIMs, again we explained that last year we were lending at 14% at the beginning and by the time we were halfway through the year that went to 13%. So that accounts for the drop in the NIMs.

In terms of where we expect to be on slide 51 going forward we are very confident that out of the things we are doing we will be able to do at least 12% growth in profit by full year. Loans and advances as at Q1 we had a drop of 0.5% compared to the same period last year. Full year last year we were at a drop of 3.3%. However, if you look at FY2018 compared to Q1 2019 there was growth. That is why we were talking about KSh 9 billion. We expect that momentum to continue for full year 2019 and therefore project at least a 10% or 11% growth in loans and advances. Deposit growth has continued to do well. In terms of non-funded to funded income we expect to be at about 38%. And non-performing loans currently the ratio is at about 11%. We expect to reduce that to about 9% given some of the measures that we have put in place.

So I think that is what we have in terms of our performance for Q1 2019. We are very optimistic about good growth of about 12% in PBT. And thank you very much. I think then we can take a number of questions so that we're able to discuss and clarify what you have as issues. Thank you very much.

Operator
Thank you. Ladies and gentlemen, if anyone would like to ask a question please 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 Ola Ogunsanya of Rencap.

Ola Ogunsanya
Good afternoon. Thank you for the presentation and taking… [Break in audio]. My first question is really just trying to understand… [Break in audio].

Patrick Nyaga
Ola, you are not very audible.

Ola Ogunsanya
Can you hear me now?

Patrick Nyaga
Yes.

Ola Ogunsanya
Okay. So if I'm looking at net interest income and non-interest revenue trends quarter on quarter there appears to be quite sharp moves. So I'm just wondering or trying to clarify, were there reclassifications between those line items during the quarter? And my second question is on asset quality. If you could just give us a bit more detail or an update on the challenges you are facing and why resolution has been slower than expected, that will be helpful. And my final question, which you touched on earlier in the presentation, is just to get a sense of how you see the competitive dynamics changing in the short to medium term given your major competitors have announced transactions. So while it's not something you're considering now, how do you think that affects the competitive dynamics? And do you think it's something you can potentially consider one or two years from now? Those are all my questions for now. Thank you.

Patrick Nyaga
Ola, just repeat your first question please.

Ola
So my first question was trying to understand if there was reclassification between interest income and non-interest revenue during the quarter.

Patrick Nyaga
Okay. Thank you very much, Ola. In terms of the… Let me start the questions from behind, the last one on the competitive dynamics in Kenya given that a number of transactions have been announced. I think our comment on that is that merging and acquisitions are good because they are probably going to make the size of the banks bigger and better for the economy. Our take right now is that the competitive landscape will probably not be significantly impacted if as a bank we get our act together and grow our business locally, focussing on the various areas we are looking at. Obviously it takes time to settle for some of these transactions. And maybe the comment you have made, is it something we are likely to consider in one to two years, my answer would be yes. For 2019 we are very clear that we are not going to enter into any transaction. However, that is something that we can consider as we study the market and as we see how the market behaves. In terms of reclassifications between non-interest and interest, no, we didn't have any reclassifications in Q1. And we probably can get the answer on asset quality from Mr Kamwangi.

Ndwiga Kamwangi
Thank you. I think the question was split into two. What are our experiences around the NPL, and then why there is slow turnaround? On our experiences around NPL I think generally it has gone as we had expected that the businesses which were showing signs of struggle would need more support, which we have continued to do. And businesses which are in the SME space will be the first ones to recover, which again we are continuing to see. And therefore as a bank we have gone out to support our customers. Maybe what may not come out from the figures is that we have intentionally gone a bit short-term. So you will not see a lot of quick turnaround in terms of the ratios because if someone is struggling you want to support them bit by bit until they recover. And when they want more money you will be more careful not to stress the business. So I think those have been the experiences around NPLs. Now, the turnaround is not actually slow. It is only that the businesses which we had given time to recover have actually done so and we have upgraded. And the ones which are continuing to struggle we have continued to support. So given that the book has not been growing in the last year as much,

then you would expect the figures may not have moved much. So we see the growth from 28.3 to 29 as normal NPL movement.

Patrick Nyaga
Now, Ola, just to go back to your question number one in terms of reclassification, if you notice that last year Q1 our lending book was quite higher compared to Q1 2019. And also given the fact that interest rates declined from 14% to 13%, so interest income on loans and advances declined. However, we were able to offset a bit of that deficit by increasing investments in our government securities because we continued growing the deposits. So you will note that loans and advances interest income went down slightly because of those two reasons, but interest on government securities grew significantly. Thank you.

Ola Ogunsanya
Thank you. I have two follow-up questions please. Just on the first question, if I look at quarter on quarter growth in interest income that was down 23% quarter on quarter, but that was obviously offset by a much stronger interest revenue performance which was up 81% quarter on quarter. My question is those are quite sharp moves in a three or four month period. What exactly was driving that? And is it comparing like for like, is what I'm trying to understand.

Patrick Nyaga
Okay. If I get your question, in terms of commissions remember the e-loans we are driving are not interest income but they are commission income. So between January this year and March 2019, the last three months, we've significantly increased our lending on the e-credit. Initially we were doing KSh 500 million. We are now doing in total both business and individuals about KSh 2.6 billion per month. Now, that has a very big potential in terms of commissions. That is actually what has driven our commission income doubly. If you notice the slide I talked about our commissions on e-credit doubled from KSh 300 million to about KSh 744 million.

Ola Ogunsanya
Thank you. I think those are all my questions for now. Thank you.

Patrick Nyaga
Thank you.

Operator
Ladies and gentlemen, if anyone else would like to ask a question please press star and then one. We will pause a moment to see if we have any further questions. It seems we have no further questions on the lines. Would you like to make any closing comments?

Patrick Nyaga
Just to thank the participants in the call for turning up and also to say that we are available in case there are any clarifications or questions. We can always handle them through email, through calls. And at the same time we project better numbers in Q2. Thank you very much.

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

END OF TRANSCRIPT