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BANKING

Co-op Bank defies South Sudan turmoil to rake in profits



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Cooperative Bank is smiling all the way to its cash vaults.

And it's not by fluke that the lender defied the turmoil in the conflict-scarred country to rake in remarkable profits. Its ingenious strategy from the onset stands it in good stead. The bank localised its brand by giving South Sudanese Government a stake. This gives it an immense advantage.

Besides, government ownership apparently appeals to the patriotism of the citizens to do business with the bank.

Analysts also point to the lender's measured and prudent expansion as another secret to its success.

Cooperative Bank's fortunes look even more striking when assessed against the dismal performance of other lenders. Regional companies with subsidiaries in South Sudan from last December experienced a substantial drop in profits and a huge loss on investment after Juba devalued its currency by 84 per cent as the government abandoned efforts to fix the exchange rate.

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When other Kenyan lenders with branches in South Sudan are counting losses thanks to the unfavourable business conditions in that country,

GOOD NEWS» BANK'S FORTUNES LOOK MORE STRIKING WHEN ASSESSED AGAINST DISMAL PERFORMANCE OF OTHER LENDERS.

Co-op Bank shakes off South Sudan turmoil to rake in healthy profits

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Lender's secret to success is that it localised its brand as South Sudanese. Government has a stake, while analysts say its measured and prudent expansion stood it in good stead

Kenya Commercial Bank, Equity Bank and CFC Sanbic have said their earnings growth for the full year ended December 2015 were slowed significantly by South Sudan unrest. This is in sharp contrast to Co-op Bank chief executive Gideon Muriuki who announced a 46.2 per cent rise in profit after tax of Sh11.7 billion for the year 2015 compared to Sh8.01 billion recorded in 2014. He said the bank's rigorous cutting of costs had finally paid off significantly for the lender.

Mr Muriuki attributed the overall performance, which saw it outpace its tier one peers in the Kenyan banking industry to the bank's improving operational efficiencies, reduced operating costs and improved customer delivery platforms.

Coop Bank's profit after tax rose by 46 per cent, the highest in the banking industry, during the year when up to 15 listed companies, the largest in Kenya's corporate history, have issued profit warning.

The lender's South Sudan subsidiary Coop Bank South Sudan contributed Sh849 million profit before tax in 2015. This is despite taking a Sh1.8 billion hit.

Mr Muriuki believes that the lender's entry strategy was right from the beginning. The decision by Coop Bank to venture in South Sudan via joint venture with local partners, the Government of South Sudan, he noted had now been proven to have been a smart move. Why? This guarantees the bank access to the

commanding heights of the economy - currently driven by the government, particularly in difficult times, Mr Muriuki told investors last week.

The Government of South Sudan virtually controls the economy on account of the nascent institutions which are not yet strong enough to be accorded independent space to run various sectors. This is seen to grant Coop Bank's subsidiary an upper hand from competitors as the government of South Sudan is well placed to tap opportunities to the advantage of the lender.

Domestication of Coop Bank is also said to have boosted the lender's fortunes in an age when economic nationalism even in East Africa is rising.

"These were clearly strong results and in the banking continuum of results seen so far, Coop Bank is a bull outlier. Coop Bank evidently navigated South Sudan, where most banks took a big hit, and that was also an interesting development. The big hike in the full year dividend will be well received as well," said Nairobi-based analyst Aly Khan Satchu.

The private sector in South Sudan is also still in its infancy stages, driven by Kenyans and Ugandans and a few South Sudan diaspora.

The decision by Coop Bank to focus on non-funded income business as opposed to lending worked also in its favour, particularly at these turbulent times of severe currency devaluation that has deeply eaten into asset books.

Besides the model which gave it a competitive edge in South Sudan, analysts also pointed to the cost-cutting exercise pursued by the lender in recent years after it sourced the services of leading global American advisory firm McKinsey and Company to undertake a "growth and efficiency review" which the bank has said is finally paying off.

"The McKinsey process has also seemingly delivered some meaningful returns. These



Cooperative Bank of Kenya group MD Gideon Muriuki during the release of the bank's 2015 profit before tax increase in Nairobi on Thursday. ROBERT NGUGI/NATION

46pc

The rate by which Coop Bank's profit after tax rose in the year ended December. This was the highest increase in the banking industry in 2015.

Sh849m

The amount that Coop Bank's South Sudan subsidiary contributed to the lender's profit before tax in 2015.

84pc

The percentage by which South Sudan devalued its currency, deeply eating into value of investments.

were the strongest results seen so far from the banking sector and probably speaks to the Model," said Mr Satchu. Sterling Capital Investment Director John Kimani said Coop's performance in South Sudan is exemplary.

"I think the results are very good relative to the results of Coop Bank peers in the banking industry. I think the lender rationalised their operations including costs and they focused on their strategic vision and mission."

This was also echoed by analyst Robert Shaw who said, "Cooperative Bank has for some time now pursued a vigorous cost cutting and retrenchment policy. If one goes into any of their branches it is clear there have been cutbacks in staff. In the bigger picture this was necessary and hence the improvement in their profit."

Going forward, Mr Muriuki said the lender would pursue a regional expansion plan based on the joint venture partnership model for its South Sudan subsidiary.

The lender has in the past said it is eyeing presence in Rwanda, Uganda, Tanzania and Ethiopia in the next five years.

Cooperative Bank has a three-branch footprint in South Sudan which analysts say limited its exposure compared by other banks who have invested in extensive branch networks, with KCB having 20 branches and Equity more than ten branches.

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Coop Bank CEO
Gideon Muriuki

FINANCE

Big banks need tougher audits: US regulator

US banking supervisors should beef up their oversight of large banks beyond stress tests with deep-dive audits and greater use of outside examiners, a top regulator said Friday.

Under a "full-scope" exam, a team of regulators would converge on the largest US banks to pull ledgers, check whether loan payments are on time and "systematically review a cross-section of bank portfolios," said Thomas Hoenig, vice chair of the Federal Deposit Insurance Corp.

Such exams, intended to uncover problems like the profusion of bad mortgages at the heart of the 2008 financial crisis, are routine at smaller banks, but not at the biggest ones, he said.

Hoenig, speaking at a conference at the Federal Reserve Bank of New York, said the Fed's use of stress tests, which analyze banks' ability to withstand a theoretical severe economic crisis, was helpful but not sufficient to protect the system.

"Supervisors of these firms have become overly reliant

on bank models, model validation reviews, stress tests, and updates from bank management as a substitute for records review and hard questioning to draw conclusions regarding a firm's condition," he said.

"Full-scope examinations delve into the quality of portfolios and their implications for long-term resilience. A full-scope exam is a point-in-time analysis of a bank's full balance-sheet quality and management competence."

Hoenig, who has previously supported breaking up the largest US banks, also took a swipe at the Fed's reliance on regulators who are stationed at large banks.

The practice causes regulators to "develop a more insular perspective" that can make it hard to question a bank's assumptions or identify potential disasters.

Hoenig said there is still a place for on-site examiners, but that they should be "subsumed" within a larger regulatory apparatus that includes a team of commissioned examiners who rotate from bank to bank.

- AFP



Buy or hold Co-op Bank for medium-long term

NSE indices: The NSE is yet to engage the right gear for a bull run. Last week, the NSE 20 Share Index appeared to reverse the gains it had made the previous week. The main index last week closed at 3,946.19 points down from the 3,958.82 points it recorded last week. On the opposite extreme, the NSE 25 Share Index closed 19.62 points higher at 4,228.22 points from the 4,208.6 points it recorded at the end of the previous week. In the same vein, the NSE All Share Index climbed marginally to settle at 145.68 points from the previous week's 144.9 points. Interestingly, a day earlier on Thursday, the local bourse put smiles on the faces of investors after growing their wealth by Sh5.2 billion to a collective total of Sh2054 trillion.

Co-op Bank: This counter has been recommended as a hold or buy for medium-to long-term investors. This follows the release of the financial results for the full year ended December 2015 by the Co-operative Bank. Impressively, Co-op Bank reported a 46 per cent jump in net profit to Sh11.7 billion from the Sh8 billion net profit the bank had posted in the 2014 financial period. This profit was largely driven by a 13.4 per cent year to year growth in operating income. Additionally, according to Mr Robert Ocheng, a research analyst at Relic Capital, there was also a significant boost from lower costs despite a 72 per cent increase in loan loss provision. Further, according to a stocks watch-list report by StanCard Bank Group Securities, this performance showed that Co-op Bank had successfully maintained its profit momentum from the 37 per cent net profit it reported in the first nine months of 2015 to a 46 per cent full year profit jump.

Additionally, according to Mr Eric Muriyoki, a research analyst at Sterling Capital Ltd, the hiring

of McKinsey & Co in 2014 to advise the bank on how to effectively cut costs while improving on its operations has paid off. For instance, although the bank suffered a one-off cost of Sh1.3 billion after laying off 160 staff members in 2014, in the 2015 financial year, its cost to income ratio dropped from 61 per cent to 53 per cent. In 2014, Co-op Bank started at a wage bill of Sh9.7 billion. "These cost-cutting measures have seen the bank save up to Sh500 million annually," says Mr Muriyoki. By the end of 2015, though, Co-op Bank had reduced its staff by more than 400.

Following these financial results, Co-op Bank's board of directors recommended a first and final dividend of 0.80 per cent, which was 60 per cent

higher than the dividend paid out in the 2014. Meanwhile, the stock's earnings per share rose 36.6 per cent to Sh 2.3. Interestingly, although other local banks with operations in South Sudan have posted poor results, Co-op Bank's Bank recorded a profit of Sh900 million compared to the Sh600 million loss reported in 2014.

According to Mr Ocheng, Co-op Bank is currently operating four branches in Juba and four non-oil collection centres. He further notes that Co-op Bank investors are likely to continue reaping gains from its Soaring Eagle transformation strategy that runs up until 2019.

"Co-op is expected to continue moving on an increased growth path with additional value in its products," he says. "Currently, it is the bank with the most diversified loan book which consists of Saccos, corporate mortgage, retail segments and asset financing."

Strikingly, last month, a market report by Cytonn Investment recommended that investors accumulate Co-op Bank. According to Cytonn, Co-op Bank had a 10.4 per cent upside potential and a 3.7 per cent dividend yield.

On Friday last week the lender closed the market at Sh20.25 per share from a traded volume of 6.9 million shares. This was a fall of 3.57 per cent from the Sh21 per share closing price that the counter had recorded on Thursday.

Nonetheless, during the intra-day trading session, the Co-op Bank stock touched a one year high of Sh23 from a low of Sh19.15 per share. Over the past one year, Co-op Bank has touched a bottom of Sh15.85 per share. It has then gone on to touch a high of Sh23 per share.

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