DYER & BLAIR INVESTMENT BANK
EARNINGS UPDATE

Founder Member of the Nairobi Securities Exchange

31ST August 2018

HOUSING FINANCE GROUP: 1H18 EARNINGS UPDATE

Dear All,

HF Group released its half year results ending 30th June 2018, posting a 95.7% y-o-y drop in profit to KES 6.8 MN. EPS for the period stands at KES 0.02 while trailing EPS stands at KES -0.07. Annualized Return on Assets (ROA) and Return on Equity (ROE) stand at 0.02% and 0.1% respectively.

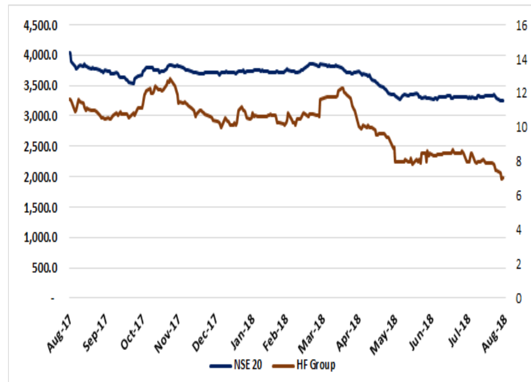
Below please find key highlights:

Net interest income declined 13.9% y-o-y to KES 1.3 BN. Interest income declined 13.2% y-o-y to KES 3.2 BN driven by a 12.4% y-o-y decrease in interest on loans and advances to KES 3.0 BN. Interest expense declined 12.7% y-o-y to KES 1.9 BN on account of a 27.1% decrease in other interest expense to KES 677.4 MN. Annualized yield on interest earning assets declined 26 bps y-o-y (up 16 bps q-o-q) to 12.0% while annualized cost of funds declined 9 bps y-o-y (up 16 bps q-o-q) to 7.1%. As a result net interest margin declined 17 bps y-o-y to 5.0%. Interest on government securities dropped 34.2% y-o-y to KES 145.7 MN despite a 17.3% y-o-y increase in government securities to KES 4.0 BN and a decrease in yields in the market with the 5 yr and the 10 yr bonds recording a 72 and 31 bps drop y-t-d

Non interest income rose 38.2% y-o-y to KES 587.8 MN mainly driven by a 63.0% y-o-y growth in other operating income to KES 433.0 MN. Total fees and commission income rose 7.2% y-o-y to KES 129.4 MN as net forex income declined 36.1% y-o-y despite the Kenyan shilling strengthening 2.5% ytd against the US dollar.

Operating expenses less loan loss provisions rose 23.1% y-o-y to KES 1.7 BN. This is attributable to a 37.0% y-o-y increase in other operating expenses to KES 845.4 MN. Cost to income ratio rose 1,838 bps y-o-y and 441 bps h-o-h to 87.5%.

HF GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE RETURN	ABSOLUTE RETURN	EXCESS RETURN
3 months	-11.3	-8.8
6 months	-31.6	-18.2
12 months	-39.2	-19.9

KEY METRICS	
Current Price (KES)	7.05
52 week Range (KES)	7:05-12.85
YTD Return (%)	(32.2)
Issued Shares (Mn)	352.4
Market Cap (USD Mn)	24.6

Recommendation	HOLD
EPS (KES)	(0.07)
NAV (KES)	28.75
P/E (x)	(105.2)
P/B (x)	0.2
Div Yld (%)	4.6

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Total equity and liabilities declined 8.5% y-o-y to KES 65.5 BN on account of a 27.7% and a 3.1% y-o-y decrease in borrowed funds and customer deposits to KES 15.6 BN and KES 36.2 BN respectively. On the assets side; customer loans and advances were down 9.8% y-o-y to KES 47.6 BN. This brought the loans to deposit ratio to 131.4% from 141.3% in the same period last year. The decline in loans is attributed to strategic de-risking by management. Investment securities held to maturity declined 37.7% y-o-y to KES 1.4 BN while investment securities available for sale rose by KES 1.5 BN to KES 2.6 BN. We expect the bank to increase its trading activities in the bonds' secondary market to take advantage of the drop in interest rates in Kenya.

Gross non-performing loans rose 12.0% y-o-y (+4.53% q-o-q) to KES 8.9 BN while interest in suspense increased 30.0% y-o-y to KES 1.5 BN. This resulted in an 8.9% y-o-y increase in total Non Performing Loans (NPL) to KES 7.4 BN. Loan loss charge during the period rose 15.4% y-o-y to KES 2.0 BN with net NPLs standing at KES 5.4 BN (up 6.8% y-o-y). NPL ratio rose 266% y-o-y to 15.7% while NPL coverage increased by 149 bps y-o-y to 26.6%.

HF Group's Core Capital to Total Risk Weighted Assets (TRWA) stands at 15.5% while Total capital to TRWA stands at 16.9%. This was above the statutory minimum core capital ratio of 10.5% and statutory minimum total capital/TRWA ratio of 14.5%. Liquidity ratio declined 552 bps y-o-y to 20.9% slightly above the minimum requirement of 20.0%.

Going forward: We maintain our view that HF Group is well positioned to gain from Jubilee government's Big Four agenda, especially under affordable housing. This is due to HF Group's niche positioning and expertise in the real estate industry and the probability that transactions in the lands registry will be made more efficient to ensure smooth implementation of affordable housing agenda. The commissioning of the Kenya Mortgage Refinance Company (KMRC), an initiative of the National Treasury and World Bank is expected to support the affordable housing agenda by providing long term funding to mortgage lenders. This may in turn see HF Group refinance its loan book (of which approximately 90.0% is in mortgages) resulting in the improvement of the group's liquidity position. HF Group's management is focused on cautiously growing its loan sales and disbursement, cost cutting and cash flow management as it continues to address its liquidity position. The group recently laid off 9.0% of its workforce at a cost of KES 100.0 MN, this is expected to results in savings in the medium to long term. The recent retainment of the lending rate cap by parliament will continue having a negative impact on the group's performance as private sector credit growth remains subdued.

On a trailing basis: HF Group is trading at a **P/E** and a **P/B** multiple of -**105.2x** and **0.2x** against industry median **P/E** and **P/B** multiples of **7.9x** and **1.0x** respectively. We maintain our **HOLD** recommendation taking into account the lender's undervaluation on a P/B basis.

PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	1H18	1H17	y-y%ch	2Q18	1Q18	2Q17	y-y% ch	q-q%ch
Interest income	3,194	3,680	(13.2)	1,581	1,613	1,830	15.7	(1.9)
Interest expense	(1,851)	(2,121)	(12.7)	(935)	(916)	(1,068)	14.2	2.2
Net interest income	1,343	1,559	(13.9)	646	697	762	17.9	(7.4)
Other operating income	433	266	63.0	236	197	169	(28.4)	20.2
Fees and commission income	129	121	7.2	60	70	68	14.1	(14.0)
Net income from forex dealings	24	38	(36.1)	7	18	14	105.2	(61.0)
Total non-interest income	587	424	38.2	303	284	252	(17.0)	6.8
Total income	1,930	1,984	(2.7)	949	981	1,013	6.8	(3.3)
Less operating expenses	(1,689)	(1,372)	23.1	(874)	(815)	(731)	(16.3)	7.2
Operating profit	241	612	(60.7)	75	166	282	275.1	(54.6)
Bad debt charge	(228)	(381)	(40.1)	(115)	(113)	N/A	56.0	2.5
Profit before tax	13	231	(94.5)	(40)	53	102	(352.6)	(176.1)
Less tax	(6)	(72)	(91.9)	10	(16)	(31)	(408.9)	(163.4)
Profit after tax	7	159	(95.7)	(30)	37	71	(333.8)	(181.6)
EPS (KES)	0.02	0.41	(95.7)	(0.40)	0.42	0.16	(139.7)	(195.8)

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES MN)

Year End: December	1H18	1Q18	1H17	y-y% ch	q-q%ch
Total shareholder's equity	11,137	11,299	11,304	(1.5)	(1.4)
Total Equity	11,137	11,299	11,304	(1.5)	(1.4)
Deposits due to other banks	380	85	82	-	-
Customer deposits	36,215	35,912	37,358	(3.1)	0.8
Borrowed funds	15,639	16,895	21,619	(27.7)	(7.4)
Other liabilities	2,140	2,650	1,260	69.9	(19.2)
Total equity and liabilities	65,510	66,840	71,623	(8.5)	(2.0)
Central bank balances	2,240	2,121	2,696	(16.9)	5.6
Deposits due from banks	1,421	2,996	3,614	(60.7)	(52.6)
Investment Securities Held to Maturity	1,417.4	1,316.7	2,276.0	(37.7)	7.7
Investment Securities; Available for sale	2,612	1,174	1,159	125.4	122.4
Customer loans and advances	47,594	48,783	52,768	(9.8)	(2.4)
Other assets	7,778	7,926	6,559	18.6	(1.9)
Intangible assets	1,006	1,018	1,180	(14.7)	(1.1)
Fixed assets	1,441	1,506	1,372	5.1	(4.3)
Total assets	65,510	66,840	71,623	(8.5)	(2.0)

(Source: Company, DBIB Research)

INVESTMENT RETURN

	1H18	1Q18	1H17	y-y bps ch	q-q bps ch
ROA (%)*	0.02	0.2	0.4	(42)	(20)
ROIC (%)*	0.1	0.5	1.0	(91)	(47)
ROE (%)*	0.1	0.7	2.8	(269)	(53)

(Source: Company, DBIB Research)
Annualized

OPERATING PERFORMANCE

	1H18	1Q18	1H17	y-y bps ch	q-q bps ch
Yield on interest earning assets (%)*	12.0	11.9	12.3	(26)	16
Cost of funds (%)*	7.1	6.9	7.2	(9)	16
Net Interest Margin (%)*	5.0	5.0	5.1	(17)	(1)
Loan-to-Deposits ratio (%)	131.4	135.8	141.3	(983)	(442)
Loan-to-Dep & Borrowed Funds ratio (%)	91.8	92.4	89.5	231	(60)
Funded Income Generating Potential (%)	81.0	81.2	83.5	(255)	(22)
Funded Income Reliance (%)	69.6	71.1	78.6	(901)	(148)
Cost to income ratio (%)	87.5	83.1	69.1	1838	441
Pre-tax margin (%)	0.7	5.4	11.7	(1100)	(474)
PAT margin (%)	0.4	3.8	8.0	(766)	(342)

(Source: Company, DBIB Research)

CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	1H18	1Q18	1H17	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	15.5	15.7	15.9	(31)	(13)
Min. Statutory Ratio (%)	10.5	10.5	10.5	0	0
Total capital/TRWA (%)	16.9	17.0	17.4	(46)	(14)
Min. Statutory Ratio (%)	14.5	14.5	14.5	0	0
Liquidity Ratio (%)	20.9	21.4	26.4	(552)	(52)
Min. Statutory Ratio (%)	20.0	20.0	20.0	0	0
Leverage Ratio (%)	17.0	16.9	15.8	122	10
Equity-to-Loans Ratio (%)	23.4	23.2	21.4	198	24
NPL Ratio (%)	15.7	14.8	13.0	266	89
NPL Coverage Ratio (%)	26.6	27.3	25.1	149	(72)
Long Term Debt to Total Liabilities and Equity (%)	23.9	25.3	30.2	(631)	(140)

**Annualized*
(Source: Company, DBIB Research)

Appendix

Company Investment ratings

Buy: Share price may generate more than 15.0% upside over the next 12 months

Overweight: Share price may generate between 5.0% and 15.0% upside over the next 12 months

Hold: Share price may fall within the range of <+5.0/ -10.0% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels. Company fundamentals however remain strong

Underweight: Share price may generate between 10.0% and 15.0% downside over the next 12 months

Sell: Share price may generate more than 15.0% downside over the next 12 months, significant business and/ or financial risks present, industry concerns

Not Rated: Counter is not within regular research coverage

Sector Investment Ratings

Overweight： Industry performance better than that of the whole market

Equal weight： Industry performance about the same as that of the whole market

Underweight： Industry performance worse than that of the whole market

Disclaimer