

# DYER & BLAIR INVESTMENT BANK

## EARNINGS UPDATE

Founder Member of the Nairobi Securities Exchange

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DYER & BLAIR  
INVESTMENT BANK

WE KNOW. YOU KNOW.

### HOUSING FINANCE GROUP: 3Q18 EARNINGS UPDATE

Dear All,

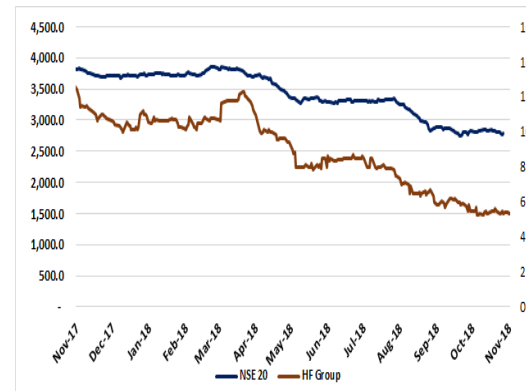
HF Group released its 3Q18 results, recording a loss of KES 332.0 MN compared to a profit of KES 159.7 MN in the same period last year. Trailing EPS stands at KES -1.04 while the period's EPS stands at KES -0.94. Annualized ROA and ROE declined 72 bps and 422 bps y-o-y to -0.7% and -4.1% respectively. HF Group issued a profit warning for the year ending 31st December 2018, stating that they expect that their results will be 25.0% or lower than that report in 31st December 2017. We expect HF Group to record a loss in FY18. Management attributes the expected decline in performance to a downward revision of the CBR rate that affected their net interest income and one off costs as a result of HF Group's redundancy exercise.

Below please find key highlights:

**Net interest income declined 17.8% y-o-y to KES 1.8 BN.** Interest income declined 14.1% y-o-y to KES 4.7 BN while interest expense declined 11.7% y-o-y to KES 2.9 BN. The 14.1% y-o-y drop in interest income was on the back of a 13.6% y-o-y drop on interest on loans and advances to KES 4.4 BN which management attributes to the Central Bank of Kenya's (CBK) decision to cut the CBR to 9.0% in July 2018. Yield on interest earning assets declined 73 bps y-o-y to 12.1%. Interest expense dropped 11.7% y-o-y courtesy of a 6.8% and a 21.4% y-o-y decline in interest on customer deposits and other interest expense to KES 1.7 BN and KES 1.1 BN respectively. Cost of funds declined 66 bps y-o-y to 7.7%. This resulted in a 7 bps y-o-y ( -49 bps q-o-q) drop in net interest margin to 4.5%.

**Non interest income shed 7.2% y-o-y to KES 598.0 MN** primarily driven by a 30.9% y-o-y decrease in fees and commission income to KES 140.2 MN. Forex income declined 29.0% y-o-y to KES 30.9 MN as other operating income gained 7.2% y-o-y to KES 426.8 MN. Funded income reliance dropped 220 bps y-o-y to 75.0% as funded income generating potential increased 132 bps y-o-y to 81.1%.

### HF GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE	ABSOLUTE	EXCESS
RETURN	RETURN	RETURN
3 months	-23.4%	-9.4%
6 months	-38.6%	-21.9%
12 months	-54.6%	-27.6%

### KEY METRICS

Current Price (KES)	5.40
52 week Range (KES)	5:25-12.25
YTD Return (%)	(48.1)
Issued Shares (Mn)	387.4
Market Cap (USD Mn)	20.4

Recommendation	HOLD
EPS (KES)	(0.94)
NAV (KES)	27.9
P/E (x)	(5.7)
P/B (x)	0.2
Div Yld (%)	4.6

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**Operating expenses (less loan loss provisions) rose 11.4% y-o-y to KES 2.4 BN.** Staff costs rose 15.7% y-o-y to KES 932.5 MN due to HF Group's staff redundancy strategy that saw the group record one off payouts. Other operating expenses declined 9.5% y-o-y to KES 1.1 BN. The cost to income ratio rose 2,445 bps y-o-y to 98.6%, this is expected to ease in the medium to long term courtesy of savings from the staff redundancy.

**HF Groups' asset book declined 10.5% y-o-y to KES 63.4 BN.** This is attributable to an 11.3% y-o-y decrease in customer loans and advances to KES 45.4 BN, a 54.1% y-o-y drop in deposits due from banks to KES 2.1 BN and a 63.2% y-o-y reduction in central bank balances to KES 2.0 BN. Investment securities rose 4x to KES 3.9 BN while other assets edged up 6.8% y-o-y (down 11.3% q-o-q) to KES 6.9 BN. Customer deposits rose 3.1% y-o-y (-4.3 q-o-q) to KES 34.7 BN whereas borrowed funds declined 35.3% y-o-y (-1.9% q-o-q) to KES 15.3 BN. Loan to deposit ratio declined 2,120 bps y-o-y to 131.1% while loans to deposit and borrowed funds ratio gained 159 bps y-o-y to 90.8%.

**Gross non-performing loans (NPL) recorded a 10.4% y-o-y expansion (+5.5% q-o-q) to KES 8.9 BN** as Interest in suspense rose 7.1% y-o-y to 1.5 BN. This resulted in an 11.1% y-o-y rise in total NPLs to KES 7.4 BN. Loan loss provision rose 45.2% y-o-y to KES 2.3 BN. The NPL ratio (Gross NPL/ Gross Loans) rose 329 bps y-o-y to 17.7% as the NPL coverage ratio went up 721 bps y-o-y to 20.7%.

**Capital Adequacy:** The bank's core capital to total risk weighted assets (TRWA) and total capital to TRWA stood at 15.3% (-30 bps y-o-y) and 17.1% (-60 bps y-o-y) respectively above statutory minimum ratios of 10.5% and 14.5% respectively. Liquidity ratio declined 314 bps y-o-y (up 201 bps q-o-q) to 22.9% slightly above the minimum requirement of 20.0%.

**Going forward:** HF Group is focused on 5 strategic initiatives: continued investment in digital channels, focus on customer service and experience excellence, deepening of full banking services, scaling up on provision of affordable and decent housing and aggressive collection of non performing loans. We are of the view that the bank's transition to a full fledged commercial bank from a mortgage bank that would have resulted in revenue diversification is ongoing but is hampered by macro and micro economic challenges. The interest rate cap coupled with the highly competitive commercial banking industry continue to pose a threat to the lender's performance. In addition, the lender's exposure to mortgage loans continues to negatively affect the bank's performance. However, the government's focus on the big four agenda especially the affordable housing, the continued push for further amendment of the rate cap and the bank's consumer focused strategy may see the lender record operating improvements.

**On a trailing basis:** HF Group is trading at a **P/E** and a **P/B** multiple of **-5.7x** and **0.2x** against industry median **P/E** and **P/B** multiples of **6.3x** and **1.1x** respectively. We issue an **UNDERWEIGHT** rating on the counter.

## PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	9M18	9M17	y-y%ch	3Q18	2Q18	3Q17	y-y% ch	q-q%ch
Interest income	4,682	5,453	(14.1)	1,488	1,581	1,773	(16.1)	(5.9)
Interest expense	(2,887)	(3,270)	(11.7)	(1,036)	(935)	(1,149)	(9.9)	10.7
Net interest income	1,795	2,183	(17.8)	452	646	624	(27.6)	(30.0)
Other operating income	427	398	7.2	(6)	236	132	(104.6)	(102.6)
Fees and commission income	140	203	(30.9)	11	60	82	(86.9)	(82.0)
Net income from forex dealings	31	44	(29.0)	7	7	5	20.3	(4.7)
Total non-interest income	598	645	(7.2)	11	303	220	(94.9)	(96.3)
Total income	2,393	2,828	(15.4)	463	949	844	(45.2)	(51.2)
Less operating expenses	(2,359)	(2,117)	11.4	(669)	(874)	(746)	(10.2)	(23.4)
Operating profit	35	711	(95.1)	(206)	75	99	(308.9)	(374.4)
Bad debt charge	(357)	(479)	(25.4)	(129)	(115)	(98)	31.6	11.7
Exceptional items	(3)	-	N/A	(3)	0	-	N/A	N/A
Profit before tax	(326)	232	(240.4)	(338)	(40)	1	N/A	739.6
Less tax	(6)	(72)	(91.2)	(1)	10	-	N/A	(105.5)
Profit after tax	(332)	160	(307.9)	(339)	(30)	1	N/A	N/A
EPS (KES)	(0.94)	0.45	(307.9)	(0.96)	(0.40)	0	N/A	139.0

N/A: value is >350.0% and <-350.0%

(Source: Company, DBIB Research)

## BALANCE SHEET SUMMARY (KES MN)

Year End: December	9M18	1H18	9M17	y-y% ch	q-q %ch
Total shareholder's equity	10,812	11,137	11,301	(4.3)	(2.9)
Minority interest	-	-	-	N/A	N/A
Total Equity	10,812	11,137	11,301	(4.3)	(2.9)
Deposits due to other banks	79	380	302	(73.9)	(79.3)
Customer deposits	34,660	36,215	33,619	3.1	(4.3)
Borrowed funds	15,348	15,639	23,735	(35.3)	(1.9)
Other liabilities	2,475	2,140	1,830	35.2	15.6
Total equity and liabilities	63,373	65,510	70,788	(10.5)	(3.3)
Central bank balances	1,975	2,240	5,370	(63.2)	(11.8)
Deposits due from banks	2,085	1,421	4,539	(54.1)	46.7
Investment Securities	3,868	1,417	731	N/A	172.9
Held for dealing securities	-	2,612	-	N/A	(100.0)
Customer loans and advances	45,431	47,594	51,194	(11.3)	(4.5)
Other assets	6,900	7,778	6,463	6.8	(11.3)
Intangible assets	990	1,006	1,130	(12.4)	(1.7)
Fixed assets	2,123	1,441	1,361	56.0	47.3
Total assets	63,373	65,510	70,788	(10.5)	(3.3)

(Source: Company, DBIB Research)

## INVESTMENT RETURN

	9M18	1H18	9M17	y-y bps ch	q-q bps ch
ROA (%)*	(0.70)	0.02	0.30	(100)	(72)
ROIC (%)*	(1.69)	0.05	0.61	(230)	(174)
ROE (%)*	(4.09)	0.12	1.88	(598)	(422)

(Source: Company, DBIB Research)

\*Annualized

## CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	9M18	1H18	9M17	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	15.3	15.6	15.0	30	(30)
Min. Statutory Ratio (%)	10.5	10.5	10.5	0	0
Total capital/TRWA (%)	17.1	16.9	16.5	60	16
Min. Statutory Ratio (%)	14.5	14.5	14.5	0	0
Liquidity Ratio (%)	22.9	20.9	26.0	(314)	201
Min. Statutory Ratio (%)	20.0	20.0	20.0	0	0
Leverage Ratio (%)	17.1	17.0	16.0	110	6
Equity-to-Loans Ratio (%)	23.8	23.4	22.1	172	40
NPL Ratio (%)	17.7	14.8	14.4	329	288
NPL Coverage Ratio (%)	30.7	27.3	23.5	721	338
Long Term Debt to Total Liabilities and Equity (%)	24.2	23.9	33.5	(931)	35
NTA/share (KES)	25.4	28.7	28.9	(351)	(339)
Book value/share (KES)	27.9	31.6	32.1	(416)	(369)

(Source: Company, DBIB Research)

## OPERATING PERFORMANCE

	9M18	1H18	9M17	y-y bps ch	q-q bps ch
Yield on interest earning assets (%)*	12.1	12.0	12.9	(73)	11
Cost of funds (%)*	7.7	7.1	8.3	(66)	60
Net Interest Margin (%)*	4.46	4.96	4.53	(7)	(49)
Loan-to-Deposits ratio (%)	131.1	131.4	152.3	(2,120)	(34)
Loan-to-Dep & Borrowed Funds ratio (%)	90.8	91.8	89.3	159	(94)
Funded Income Generating Potential (%)	81.1	81.0	79.8	132	11
Funded Income Reliance (%)	75.01	69.59	77.21	(220)	542
Cost to income ratio (%)	98.6	74.9	74.1	2,445	2369
Pre-tax margin (%)	(13.6)	8.2	1563.4	N/A	(2,181)
PAT margin (%)	(13.9)	5.6	2001.8	N/A	(1,952)

\*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

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