



### HF GROUP: FY19 EARNINGS UPDATE

Dear All,

HF Group released its FY19 results, posting a loss of KES 110.1 MN, 81.6% lower than the loss recorded in FY18. Loss per share for the period stands at KES 0.29. ROA stands at -0.2x (+79 bps y-o-y) against an industry median of 2.4x while ROE stands at -1.1x (+469 bps y-o-y) against a industry median of 16.7x.

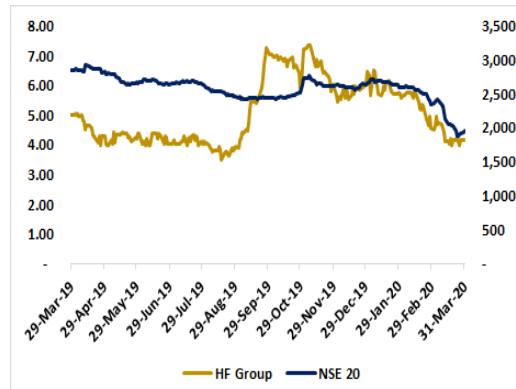
Below please find key highlights:

**Net interest income declined 13.2% y-o-y to KES 2.0 BN** occasioned by a 15.4% y-o-y drop in interest income to KES 5.1 BN and a 16.7% y-o-y drop in interest expense to KES 3.1 BN. Yield on interest earning assets declined 87 bps y-o-y to 11.5% whereas cost of funds declined 46 bps y-o-y to 7.3%. As a result, net interest margin dropped 41 bps y-o-y to 4.3%.

**Interest income from loans and advances dropped 17.4% y-o-y to KES 4.7 BN** placing the yield on loans at 12.1%, down 90 bps y-o-y. Interest income from government securities edged up 23.8% y-o-y to KES 419.4 MN placing the yield on government securities at 9.1%, down 144 bps y-o-y. Interest expense from customer deposits declined 17.7% y-o-y to KES 1.8 BN placing the cost of deposits at 4.8%, down 148 bps y-o-y.

**Non-funded income rose 6.4% y-o-y to KES 1.4 BN**, largely on the back of a 91.2% y-o-y growth in fees and commissions to 410.5 MN; fees and commissions on loans edged up 191.7% y-o-y to KES 183.6 MN whereas other fees and commissions grew by 49.5% to KES 226.9 MN. These gains were however partially eroded by the 11.5% y-o-y decline in other income to 943.6 MN. Forex trading income stood at KES 50.2 MN, up 31.4% y-o-y. Funded income reliance ratio shed 483 bps y-o-y to 58.4%.

#### HF GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE RETURN	ABSOLUTE RETURN	EXCESS RETURN
3 months (%)	(35.3)	(8.0)
6 months (%)	(40.5)	(19.6)
12 months (%)	(16.4)	15.8

#### KEY METRICS

Current Price (KES)	4.18
52 week Range (KES)	3.50-7.10
YTD Return (%)	(34.1)
Issued Shares (Mn)	387.4
Market Cap (KES Bn)	1.6

Recommendation	Hold
Target Price	Under Review
EPS (KES)	(0.29)
NAV (KES)	26.60
P/E (x)	(14.4)
P/B (x)	0.2

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**Operating expenses (less loan loss provisions) dropped 18.1% y-o-y to KES 3.2 BN** courtesy of a 12.1% y-o-y decline in staff costs to KES 1.1 BN and a 23.3% y-o-y decrease in other operating expenses to KES 1.7 BN. Bad debt charge declined 6.8% y-o-y to KES 350.4 MN. Cost to income dropped by 1,394 bps y-o-y to 93.8%.

**Total assets declined 6.8% y-o-y to KES 56.4 BN.** Customer loans and advances edged down 11.3% y-o-y to KES 38.6 BN. Held to maturity securities declined 17.2% y-o-y to KES 427.1 MN while investment securities available for sale rose 54.9% y-o-y to KES 4.2 BN.

**Customer deposits recorded a 7.7% y-o-y upswing to KES 37.4 BN.** Borrowed funds declined 56.9% y-o-y to KES 5.8 BN partially on account of the settlement of the group's KES 3.0 BN medium term note in October 2019. Loans to deposits ratio declined 2,203 bps y-o-y to 103.1% while the loan to deposits and borrowed funds ratio dropped 91 bps y-o-y to 89.2%.

**Gross non-performing loans dropped 7.6% y-o-y to KES 12.3 BN.** Interest in suspense rose 29.2% y-o-y at KES 3.2 BN. As a result, total NPLs (Gross NPLs less interest in suspense) dropped 16.1% y-o-y to KES 9.1 BN. The NPL ratio edged up 72 bps y-o-y to 24.2% while the NPL coverage ratio rose 987 bps y-o-y to 29.2%.

**Capital Adequacy:** HFC's core capital ratio (Core capital/TRWA) declined 114 bps y-o-y to 13.0% above the statutory minimum of 10.5% whereas Total capital/TRWA ratio declined 129 bps y-o-y to 14.3% slightly above the statutory minimum ratio of 14.5%. Liquidity ratio remained fairly flat at 20.8%, also slightly above the minimum requirement of 20.0%.

**Going forward:** While we expect the lull in the real estate sector to continue being a key impediment to the company's performance, we remain optimistic about the prospects of management's strategy to reduce exposure to the real estate sector through ceasing the construction of new units going forward to focus their mainstream business. We maintain that the group is well positioned to benefit from the establishment of The Kenya Mortgage Refinance Corporation, an initiative by National Treasury and World Bank that is intended to support the affordable housing agenda by providing long term funding to mortgage lenders. This entity would give HF Group the opportunity to refinance its mortgage loans, improving its asset liability risk and liquidity management. KMRC has so far been set up and has received commitments to initial funding, although it remains unclear when its operations will commence.

**On a trailing basis:** On a trailing basis, HF Group is trading at a P/E multiple of 14.4x, against the sector median of 5.1x and a P/B multiple of 0.2x, against the sector median of 0.8x. We issue a **HOLD** recommendation.

## PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	FY19	FY18	y-y% ch	4Q19	3Q19	4Q18	y-y% ch	q-q% ch
Interest income	5,117	6,046	(15.4)	992	1,428	1,364	(27.3)	(30.5)
Interest expense	3,149	3,780	(16.7)	742	4,077	893	(17.0)	(81.8)
Net interest income	1,968	2,266	(13.2)	250	690	471	(46.8)	(63.7)
Other operating income	943	1,066	(11.6)	223	8	527	(57.7)	2840.0
Fees and commission income	410	215	91.2	89	135	187	(52.4)	(33.8)
Net income from forex dealings	50	38	31.4	22	14	7	198.6	59.1
Total non-interest income	1,403	1,319	6.4	333	156	721	(53.8)	114.1
Total income	3,371	3,585	(6.0)	584	846	1,192	(51.0)	(31.0)
Less operating expenses	3,160	3,861	(18.1)	879	3,947	1,145	(23.2)	(77.7)
Operating profit	211	(276)	(176.3)	(296)	231	47	(730.8)	(228.0)
Bad debt charge	(350)	(376)	(6.8)	237	(218)	(376)	(163.1)	(208.7)
Exceptional items	2	9	(76.2)	2	0	12	(82.2)	-
Profit before income tax	(138)	(643)	(78.6)	(56)	13	(317)	(82.2)	(537.3)
Less tax	28	45	(37.8)	31	(0)	51	(39.3)	(65,09.3)
Profit after tax	(110)	(598)	(81.6)	(25)	12	(266)	(90.4)	(305.4)

(Source: Company, DBIB Research)

## BALANCE SHEET SUMMARY (KES MN)

Year End: December	FY19	FY18	9M19	y-y% ch	q-q% ch
Total Equity	10,242	10,371	10,441	(1.2)	(1.9)
Deposits due to other banks	528	578	73	(8.6)	626.7
Customer deposits	37,400	34,721	34,608	7.7	8.1
Borrowed funds	5,804	13,469	9,931	(56.9)	(41.6)
Other liabilities	2,481	1,410	2,358	75.9	5.2
Total equity and liabilities	56,455	60,549	57,411	(6.8)	(1.7)
Central bank balances	2,288	2,423	1,572	(5.6)	45.6
Deposits due from banks	1,167	2,041	2,677	(42.8)	(56.4)
Investment Securities HTM	427	516	105	(17.2)	308.0
Investment Securities AFS	4,176	2,696	3,495	54.9	19.5
Customer loans and advances	38,552	43,440	39,201	(11.3)	(1.7)
Other investments	2,988	1,690	3,940	76.8	(24.2)
Other assets	4,140	4,613	4,268	(10.2)	(3.0)
Intangible assets	864	1,008	914	(14.3)	(5.5)
Fixed assets	1,854	2,122	1,241	(12.7)	49.4
Total assets	56,455	60,549	57,411	(6.8)	(1.7)

(Source: Company, DBIB Research)

## INVESTMENT RETURN

	FY19	FY18	9M19	y-y bps ch	q-q bps ch
ROA (%)*	(0.2)	(1.0)	(0.2)	79	0
ROIC (%)*	(0.7)	(2.5)	(0.6)	182	(13)
ROE (%)*	(1.1)	(5.8)	(1.1)	469	1

(Source: Company, DBIB Research)

\*Annualized

## CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	1H19	1Q19	1H18	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	13.0	14.2	14.2	(114)	(117)
Min. Statutory Ratio (%)	10.5	10.5	10.5	0	0
Total capital/TRWA (%)	14.3	15.6	15.4	(129)	(117)
Min. Statutory Ratio (%)	14.5	14.5	14.5	0	0
Liquidity Ratio (%)	20.8	20.9	21.2	(12)	(44)
Min. Statutory Ratio (%)	20.0	20.0	20.0	0	0
Leverage Ratio (%)	18.1	17.1	18.2	101	(4)
Equity-to-Loans Ratio (%)	26.6	23.9	26.6	269	(7)
NPL Ratio (%)**	24.2	23.5	24.4	72	(18)
NPL Coverage Ratio (%)**	29.2	19.4	27.5	987	170
LTD to Total Liabilities and Equity (%)	10.3	22.2	17.3	(1196)	(702)
NTA/share (KES)	24.4	24.3	(18.0)	4	4239
Book value/share (KES)	26.6	27.0	27.1	(34)	(52)

(Source: Company, DBIB Research)

\*\*Total Loan Portfolio net of Interbank Lending

## OPERATING PERFORMANCE

	FY19	FY18	9M19	y-y bps ch	q-q bps ch
Yield on interest earning assets (%) *	11.5	12.4	12.1	(87)	(55)
Cost of funds (%)*	7.3	7.8	7.2	(46)	9
Net Interest Margin (%) *	4.3	4.7	4.9	(41)	(64)
Loan-to-Deposits ratio (%)	103.1	125.1	113.3	(2,203)	(1,019)
Loan-to-Dep.&Borrowed Funds ratio (%)	89.2	90.1	88.0	(91)	122
Funded Income Generating Potential (%)	78.5	80.4	79.2	(191)	(70)
Funded Income Reliance (%)	58.4	63.2	61.6	(483)	(324)
Cost to income ratio (%)	93.8	107.7	81.8	(1,394)	1,191
Pre-tax margin (%)	(4.1)	(17.9)	(2.9)	1,384	(117)
PAT margin (%)	(3.3)	(16.7)	(3.0)	1,342	(23)

(Source: Company, DBIB Research)

\* Annualized

## 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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