

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.

HF GROUP: 1Q20 EARNINGS UPDATE

Dear All,

HF Group released its 1Q20 results posting a loss after tax of KES 0.6 MN, a significant improvement from a loss after tax of KES 158.3 MN recorded in 1Q19 primarily on account of reduced interest on borrowed funds as the group completed the repayment of its KES 3.0 BN bond in October last year; and lower operating expenses. Trailing EPS stands at KES 0.11 while the period's EPS stands at KES (0.01).

Below please find key highlights:

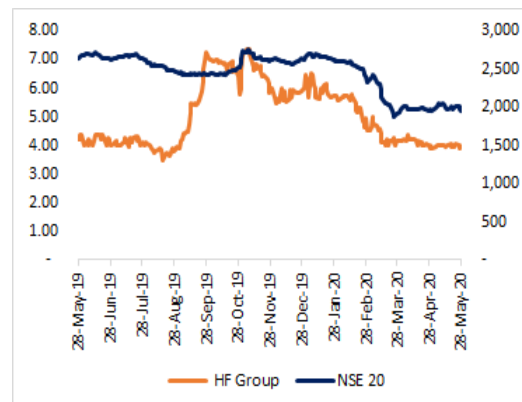
Net interest income rose 13.7% y-o-y to KES 580.7 MN as a result of a 7.8% y-o-y decline in interest income to KES 1.2 BN and a 20.9% y-o-y drop in interest expense to KES 664.1 MN. Annualised yield on interest earning assets declined 30 bps y-o-y to 11.2% whereas cost of funds declined 116 bps y-o-y (-132 bps q-o-q) to 6.0%. As a result, net interest margin edged up 85 bps y-o-y to 5.2%.

Interest income from loans and advances dropped 10.8% y-o-y to KES 1.1 BN on account of the downward revision of CBR rates as the government takes on expansionary measures to buffer the economy against shocks arising from the COVID-19 crisis. This placed the annualised yield on loans at 11.8%, down 52 bps y-o-y. Interest income from government securities edged up 24.6% y-o-y to KES 113.7 MN placing annualised yield on government securities at 9.6%, up 48 bps y-o-y.

Interest expense from customer deposits rose by 5.9% y-o-y to KES 488.0 MN placing annualised cost of deposits at 5.3%, down 45 bps y-o-y. Other interest expenses shed 211.3% y-o-y to KES 148.0 MN following the full redemption of tranche II of the group's KES 3.0 BN medium term note which matured in October 2019.

Non-funded income dropped 2.0% y-o-y (23.9% q-o-q) to KES 253.2 MN. Net income from forex dealings edged up 198.6% y-o-y to KES 18.8 MN. These gains were however eroded by a 10.3% y-o-y decline in other operating income to KES 114.3 MN.

HF GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE RETURN	ABSOLUTE RETURN	EXCESS RETURN
3 months (%)	(12.7)	3.2
6 months (%)	(33.8)	(9.0)
12 months (%)	(6.1)	19.7

KEY METRICS

Current Price (KES)	3.97
52 week Range (KES)	3.50-7.34
YTD Return (%)	(37.4)
Issued Shares (MN)	387.4
Market Cap (KES BN)	1.5

Recommendation	Hold
Target Price	Under Review
Trailing EPS (KES)	0.11
NAV (KES)	26.56
P/E (x)	36.5
P/B (x)	0.2

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Fees and commissions income dropped by 3.7% y-o-y to KES 120.4 MN; Fees and commissions on loans shed 61.9% y-o-y to KES 24.4 MN whereas other fees and commissions grew by 57.4% y-o-y to KES 96.0 MN. Consequently, funded income reliance ratio edged up 323 bps y-o-y to 69.6%.

Operating expenses (less loan loss provisions) dropped 7.7% y-o-y to KES 689.6 MN courtesy of a 12.0% y-o-y decrease in other operating expenses to KES 433.2 MN. Staff costs remained fairly constant at KES 256.3 MN (+0.5% y-o-y). Cost to income ratio dropped by 1,447 bps y-o-y to 82.7%. Bad debt charge declined 23.4% y-o-y to KES 137.6 MN.

Total assets declined 4.1% y-o-y to KES 56.6 BN. Customer loans and advances edged down 8.5% y-o-y to KES 38.4 BN. Held to maturity securities declined 4.3% y-o-y (+32.5% q-o-q) to KES 566.0 MN while available for sale investment securities rose 47.8% y-o-y (+7.0% q-o-q) to KES 4.5 BN.

Customer deposits recorded an 11.8% y-o-y upswing to KES 38.0 BN. Borrowed funds declined by 55.2% y-o-y (+0.5% q-o-q) 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 2,373 bps y-o-y to 99.3% while the loan to deposits and borrowed funds ratio dropped 276 bps y-o-y to 86.3%.

Gross non-performing loans dropped 5.8% y-o-y to KES 12.2 BN while interest in suspense rose by 28.4% y-o-y to KES 3.4 BN. As a result, total NPLs dropped 14.6% y-o-y to KES 8.8 BN. The NPL ratio edged up 54 bps y-o-y to 24.1% while the NPL coverage ratio rose 931 bps y-o-y to 33.5%. We anticipate increased non-performance in the coming quarters on the back of both depressed performance in the real estate sector and an overall challenging business environment occasioned by the COVID-19 crisis.

Capital Adequacy: HFC's core capital ratio (Core capital/TRWA) declined 216 bps y-o-y to 12.1% above the statutory minimum of 10.5% whereas Total capital/TRWA ratio declined 227 bps y-o-y to 13.3% below the statutory minimum ratio of 14.5%. Liquidity ratio edged up 46 bps y-o-y to 21.3%, slightly above the minimum statutory requirement of 20.0%.

On a trailing basis: On a trailing basis, HF Group is trading at a P/E multiple of – 36.5x, against a sector median of 5.3x and a P/B multiple of 0.2x, against a sector median of 0.7x. Its ROA stands at 0.1% against a sector median of 2.3% whereas its ROE stands at 0.4% against a sector median of 17.1%. We maintain our **HOLD** recommendation.

PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	1Q20	1Q19	4Q19	y-y% ch	q-q% ch
Interest income	1,245	1,351	992	(7.8)	25.5
Interest expense	664	840	742	(20.9)	(10.4)
Net interest income	581	511	250	13.7	132.0
Other operating income	114	127	223	(10.3)	(48.7)
Fees and commission income	120	125	89	(3.7)	35.3
Net income from forex dealings	19	6	22	198.6	(12.8)
Total non-interest income	254	259	333	(2.0)	(23.9)
Total income	834	769	584	8.4	42.9
Less operating expenses	690	747	879	(7.7)	(21.6)
Operating profit	145	22	(296)	555.9	(148.9)
Bad debt charge	138	180	237	(23.4)	(41.9)
Exceptional items	0	0	2	-	(100.0)
Profit before tax	7	(158)	(56)	104.5	112.5
Less tax	(8)	(1)	31	1,095.3	124.8
Profit after tax	(1)	(158)	(25)	99.6	97.5

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES MN)

Year End: December	1Q20	1Q19	FY19	y-y% ch	q-q% ch
Total shareholder's equity	10,217	10,265	10,242	(0.5)	(0.2)
Total Equity	10,217	10,265	10,242	(0.5)	(0.2)
Deposits due to other banks	674	122	528	450.3	27.6
Customer deposits	37,990	33,995	37,400	11.8	1.6
Borrowed funds	5,834	13,019	5,804	(55.2)	0.5
Other liabilities	1,915	1,678	2,481	14.1	(22.8)
Total equity and liabilities	56,630	59,080	56,455	(4.1)	0.3
Central bank balances	2,204	2,079	2,288	6.0	(3.7)
Deposits due from banks	985	1,330	1,167	(26.0)	(15.6)
Investment Securities HTM	566	591	427	(4.3)	32.5
Investment Securities AFS	4,467	3,023	4,176	47.8	7.0
Customer loans and advances	38,408	41,986	38,552	(8.5)	(0.4)
Other investments	2,987	1,692	2,988	76.5	(0.0)
Other assets	4,368	5,337	4,140	(18.2)	5.5
Intangible assets	829	961	864	(13.7)	(4.0)
Fixed assets	1,817	2,080	1,854	(12.7)	(2.0)
Total assets	56,630	59,080	56,455	(4.1)	0.3

(Source: Company, DBIB Research)

INVESTMENT RETURN

	1Q20*	FY19	1Q19*	y-y bps ch	q-q bps ch
ROA (%)	(0.004)	(0.2)	(1.1)	107	19
ROIC (%)	(0.005)	(0.7)	(1.1)	110	68
ROE (%)	(0.025)	(1.1)	(6.2)	614	105

(Source: Company, DBIB Research)

*Annualized

CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	1Q20	FY19	1Q19	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	12.1	13.0	14.2	(216)	(96)
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	13.3	14.3	15.6	(227)	(96)
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	21.3	20.8	20.8	46	50
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-
Leverage Ratio (%)	18.0	18.1	17.4	67	(10)
Equity-to-Loans Ratio (%)	26.6	26.6	24.4	215	3
NPL Ratio** (%)	24.1	24.2	23.6	54	(7)
NPL Coverage Ratio** (%)	33.5	29.2	24.2	931	425
LTD to Total Liabilities & Equity (%)	10.3	10.3	22.0	(1,174)	2
Book value/share (KES)	26.6	26.6	26.5	7	(7)

(Source: Company, DBIB Research)

**Total Loan Portfolio net of Interbank Lending

OPERATING PERFORMANCE

	1Q20	FY19	1Q19	y-y bps ch	q-q bps ch
Yield on interest earning assets* (%)	11.2	11.5	11.5	(30)	(34)
Cost of funds* (%)	6.0	7.3	7.1	(116)	(132)
Net Interest Margin* (%)	5.2	4.3	4.4	85	98
Loan-to-Deposits ratio (%)	99.3	103.1	123.1	(2,373)	(374)
Loan-to-Dep.&Borrowed Funds ratio (%)	86.3	89.2	89.1	(276)	(292)
Funded Income Generating Potential (%)	78.4	78.5	79.4	(99)	(6)
Funded Income Reliance (%)	69.6	58.4	66.4	323	1,124
Cost to income ratio (%)	82.7	93.8	97.1	(1,447)	(1,110)
Pre-tax margin (%)	0.8	(4.1)	(20.5)	2,133	493
PAT margin (%)	(0.1)	(3.3)	(20.6)	2,050	319

(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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