



HF Group Q1'2020 Earnings Note

HF Group Q1'2020 Earnings Note

Valuation Summary

- We are of the view that HF Group is a “**hold**” with a target price of Kshs 4.3, representing an upside of 7.3%, from the current price of Kshs 4.0 as of 29th May 2020,
- HF Group is currently trading at a P/TBV of 0.2x vs an industry average of 1.0x, with a P/E ratio of 2.6 x compared to an industry average of 5.4x.

Key Highlights

- Housing Finance (HF) put on sale customer houses worth an estimated Kshs 2.0 bn, pointing to widespread distress in the real estate sector. The lender has signed up auctioneers to sell off the houses and commercial buildings, in a move aimed at trimming its non-performing loans portfolio, and,

Income Statement

- HF Group released its Q1'2020 financial results, recording a loss per share of Kshs 0.016 in Q1'2020, an improvement from a loss per share of Kshs 4.1 recorded in Q1'2019, not in-line with our expectations of a Kshs 3.6 loss per share. This variance can be attributed to a 13.7% increase in net interest income to Kshs 580.7mn from Kshs 510.8 mn higher than the 13.0% expected to decline to Kshs 444.2 mn. The performance of the group can be attributed to a faster 10.8% decline in total operating expenses coupled with an 8.4% increase in total operating income,
 - Total Operating Income rose by 8.4% to Kshs 0.83 bn in Q1'2020 from Kshs 0.77 bn, this can be attributed to a 13.7% increase in Net Interest Income (NII) to Kshs 0.6 bn from Kshs 0.5 bn recorded in Q1'2019, outpacing a 2.0% decline in Non-funded Income (NFI) to Kshs 253.5 mn from Kshs 258.7 mn seen in Q1'2020,
 - Interest income declined by 7.8% to Kshs 1.2 bn, from Kshs 1.4 bn in Q1'2019. This was driven by a 10.8% decline in interest income from loans and advances to Kshs 1.1 bn, from Kshs 1.3 bn in Q1'2019. Interest income on government securities, however, recorded a 24.6% increase to Kshs 113.7mn, from Kshs 91.2 mn in Q1'2019. The yield on interest-earning assets declined to 11.0%, from 11.4% in Q1'2019, due to the faster 13.4% decline in trailing interest income compared with the 9.7% decline in the average interest-earning assets (IEA). Net Interest Margin (NIM) increased to 4.5%, from 4.1% in Q1'2019, following the slower 2.0% decline in Trailing NII, that outpaced the 9.7% decline in IEA,
 - Interest expense declined by 20.9% to Kshs 0.7 bn, from Kshs 0.8 bn in Q1'2019, following a 58.8% decline in other interest income to Kshs 0.1 bn in Q1'2020 from Kshs 0.4 bn in Q1'2019.
- Interest
- income on customer deposits, however, increased by 5.9% to Kshs 0.48 bn, from Kshs 0.46 bn in Q1'2019. Cost of funds declined to 6.5% from the 7.3% recorded in Q1'2019, following the faster 20.9% decline in interest expense that outpaced the 8.4% decline in the average interest-bearing liabilities (IBL),
 - Non-Funded Income declined by 2.0% to Kshs 253.5 mn from Kshs 258.7 mn in Q1'2019. The

decline was mainly due to a 61.9 % decline in Fees & Commissions to Kshs 24.4 mn, from Kshs 64.1 mn, coupled with a 10.3% decline in Other Income to Kshs 114.3 mn from Kshs 127.4 mn. Forex Trading Income however increased by 198.6% to Kshs 18.8 mn in Q1'2020 to Kshs 6.3 mn in Q1'2019. The revenue mix shifted to 70:30 funded to non-funded income, from 66:34, owing to the 13.7% increase in NII, with NFI declining by 2.0%,

- Total operating expenses declined by 10.8% to Kshs 0.8 bn from Kshs 0.9 bn seen in Q1'2019. This is attributable to a 23.4% decline in Loan Loss Provisions to Kshs 0.2 bn from Kshs 0.1 bn in Q1'2019, coupled with a 12.0% decline in Other Operating Expenses from Kshs 0.5 bn to Kshs 0.4 bn in Q1'2020. Staff Costs however increased by 0.5% to Kshs 256.4 mn from Kshs 255.0 mn in Q1'2019, and,
- The Cost to Income Ratio (CIR) improved to 99.2%, from 120.5% in Q1'2019. Without LLP, the cost to income ratio also improved, to 82.7% from 97.1% in Q1'2019, an indication of improved efficiency and,
- HF Group recorded a profit before tax of Kshs 7.0 mn an improvement from a loss before tax of Kshs 157.7 mn in Q1'2019. The Group's Loss after Tax improved to Kshs 0.6 mn in Q1'2020, from the Kshs 158.3 mn loss recorded in Q1'2019.

Balance Sheet

- The company's balance sheet recorded a contraction as total assets declined by 4.1% from Kshs 59.1 bn to Kshs 56.6 bn in Q1'2020. This is attributable to an 8.5% decline in the loan book to Kshs 38.4 bn from Kshs 42.0 bn recorded in Q1'2019, coupled with a 26.0% decline in Placements to Kshs 1.0 bn from Kshs 2.0 bn recorded in Q1'2019. Government securities, however, increased by 39.3% to Kshs 5.0 bn from the Kshs 3.6 bn recorded in Q1'2019,
- Total liabilities declined by 4.9% to Kshs 46.4 bn, from Kshs 48.8 bn in Q1'2019, driven by a 55.2% decline in borrowings to Kshs 5.8 bn, from Kshs 13.0 bn in Q1'2019. This drop can be attributed to the Kshs 3.0 bn corporate bond that was retired during the last quarter of 2019. Customer deposits on the other hand increased by 11.8% to Kshs 38.0 bn from Kshs 34.0 bn in Q1'2019. Deposits per branch increased from Kshs 1.5 bn to Kshs 1.8 bn in Q1'2019 as the number of branches declined by 1 to 21 branches from 22 branches in Q1'2019,
- The loan to deposit ratio declined to 101.1% from 123.5% in Q1'2019 owing to the 8.5% decline in loans, despite the 11.5% increase in deposits,
- The bank's Non-performing Loans (NPLs) declined by 5.8% to Kshs 12.2 bn from Kshs 13.0 bn recorded in Q1'2019. Consequently, the NPL ratio improved marginally to 27.3% from the 27.5% following the faster 5.8% decline in NPLs that outpaced the 5.0% decline in gross loans that came in at Kshs 44.8 bn in Q1'2020 from Kshs 47.1 bn recorded in Q1'2019,
- Shareholders' funds declined by 4.9% to Kshs 10.2 bn in Q1'2020, from Kshs 10.3 bn in Q1'2019, this is attributable to the 0.1 bn negative Retained earnings recorded in Q1'2020 compared to the Kshs 0.8 bn recorded in Q1'2019. This effect was however mitigated by a 37.3% increase in statutory loan loss reserves to Kshs 3.1 bn from Kshs 2.2 bn recorded in Q1'2019,
- HF Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 12.4%, 1.9% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 13.7% below the statutory requirement by 0.8% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 12.2%, while total capital to risk-weighted assets came in at 13.4%, and,
- The bank currently has a Return on Average Assets (ROaA) of 0.1%, and a Return on Average Equity (ROaE) of 0.5%.

Key Take-Outs:

1. Despite the tough economic times amid the Coronavirus Pandemic, the bank experienced an improvement in asset quality unlike most listed banks with Non-performing Loans (NPLs) declined by 5.8% to Kshs 12.2 bn from Kshs 13.0 bn recorded in Q1'2019. Consequently, the NPL ratio

improved marginally to 27.3% from the 27.5% following the faster 5.8% decline in NPLs that outpaced the 5.0% decline in gross loans that came in at Kshs 44.8 bn in Q1'2020 from Kshs 47.1 bn recorded in Q1'2019. Putting into consideration the current state of affairs regarding the COVID-19 pandemic, there is a lot more to be done to mitigate the effects experienced in the economy.

- The bank recorded a decline on the NFI income segment, which recorded a 2.0% decline y/y, largely due to a 61.9 % decrease in Fees & Commissions to Kshs 24.4 mn, from Kshs 64.1 mn, coupled with a 10.3% decrease in Other Income to Kshs 114.3 mn from Kshs 127.4 mn. Consequently, NFI contribution to total income declined by 3.2% points to 30.4% from 33.6% in Q1'2019. This is however above the current industry average of 22.8%, and,
- There was an improvement in efficiency levels as the cost to income ratio without LLP improved to 82.7%, from 97.1% in Q1'2019. The improvement was largely attributable to a 23.4% decline in Loan Loss Provisions.

Going forward, the factors that would drive the bank's growth would be:

- Although HF Group has a long way to go as a conventional bank, it has recorded commendable performance with the bank beginning to show signs of profitability. They will ultimately have to adjust their business model, or couple up with a strong bank with a sizeable asset base, and a strong deposit gathering capability, in an effort to capitalize on HF's strength in mortgages and real estate development.

Below is a summary of the bank's performance:

Balance Sheet Items	Q1'19	Q1'2020	y/y change	Q1'2020f	Projected y/y change	Variance in Growth Actual vs. Expected
Net loans	42.0	38.4	(8.5%)	37.9	(9.8%)	1.3%
Total Assets	59.1	56.6	(4.1%)	55.1	(6.7%)	2.5%
Customer Deposits	34.0	38.0	11.8%	36.6	7.7%	4.0%
Total Liabilities	48.8	46.4	-4.9%	45.0	(7.8%)	2.8%
Shareholder's Funds	10.3	10.2	(0.5%)	10.1	(1.7%)	1.3%

Balance Sheet Ratios	Q1'2019	Q1'2020	y/y change
Loan to deposit ratio	123.5%	101.1%	(22.4%)
Return on Average Equity	-7.4%	0.5%	7.8%
Return on Average Assets	(1.3%)	0.1%	1.3%

Income Statement	Q1'2019	Q1'2020	y/y change	Q1'2020f	Projected y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	0.5	0.6	13.7%	0.4	(13.0%)	26.7%
Net non-Interest Income	0.3	0.3	(2.0%)	0.2	(20.8%)	18.8%
Total Operating income	0.8	0.8	8.4%	0.6	(15.7%)	24.1%

Income Statement	Q1'2019	Q1'2020	y/y change	Q1'2020f	Projected y/y change	Variance in Growth Actual vs. Expected
Loan Loss provision	(0.2)	(0.1)	(23.4%)	(0.2)	(12.0%)	(11.4%)
Total Operating expenses	(0.9)	(0.8)	(10.8%)	(0.8)	(12.1%)	1.3%
Profit before tax	(0.2)	0.0	(104.5%)	(0.2)	5.5%	(109.9%)
Profit after tax	(0.2)	(0.001)	(99.6%)	(0.1)	(21.2%)	(78.4%)
Core EPS	(0.4)	(0.002)	(99.6%)	(0.3)	(21.2%)	(78.4%)

Income Statement Ratios	Q1'2019	Q1'2020	y/y change
Yield from interest-earning assets	11.4%	11.2%	(0.3%)
Cost of funding	7.4%	6.5%	(0.9%)
Net Interest Spread	4.0%	4.7%	0.7%
Net Interest Margin	4.1%	4.5%	0.4%
Cost of Risk	23.4%	16.5%	(6.9%)
Net Interest Income as % of operating income	66.4%	69.6%	3.2%
Non-Funded Income as a % of operating income	33.6%	30.4%	(3.2%)
Cost to Income Ratio	120.5%	99.2%	(21.3%)

Capital Adequacy Ratios	Q1'2019	Q1'2020
Core Capital/Total Liabilities	19.0%	13.8%
Minimum Statutory ratio	8.0%	8.0%
Excess	11.0%	5.8%
Core Capital/Total Risk-Weighted Assets	14.2%	12.1%
Minimum Statutory ratio	10.5%	10.5%
Excess	3.7%	1.6%
Total Capital/Total Risk-Weighted Assets	15.6%	13.3%
Minimum Statutory ratio	14.5%	14.5%
Excess	1.1%	-1.2%
Liquidity Ratio	20.8%	21.3%

Capital Adequacy Ratios	Q1'2019	Q1'2020
Minimum Statutory ratio	20.0%	20.0%
Excess	0.8%	1.3%
Adjusted core capital/ total deposit liabilities	19.4%	13.9%
Adjusted core capital/ total risk-weighted assets	14.5%	12.2%
Adjusted total capital/ total risk-weighted assets	15.9%	13.4%

Liason House, StateHouse Avenue
The Chancery, Valley Road
www.cytonn.com
Generated By Cytonn Report

A product of **Cytonn Technologies**