

Housing Finance

Bloomberg: HFCL KN Reuters: HFCK.NR



15th December 2021

We recommend a **SELL** on Housing Finance, with a target price of KES 3.79, representing an downside of 4.6% from the current market price of KES 3.97 as at 10/12/2021. The stock is currently trading at a trailing P/B of 0.2x and a forward P/B of 0.1x.

Key Considerations

- a) **Net interest income:** While interest expenses have registered steady decline over the past 4 years, declining interest income - from lower interest on loans advanced - continues to weigh down on net interest income growth. Cost of funds eased by 100 bps to 4.0% in 3Q2021. We forecast the cost of funds to ease to 3.6% in FY2025. We expect NIMs to grow by 80 bps y/y
- b) **Non-funded income:** Non-funded income registered 12.2% y/y growth in 3Q2021. We expect continued growth as the bank continues to focus on its digitization strategy. We expect NFI contribution to total income to grow to 38.4% in FY2025.
- c) **Operational efficiency:** While operating expenses excluding provisions improved (-2.9% y/y) in 3Q2021, the cost to income ratio excluding provisions rose to 119.4% due to lower operating income (-9.4% y/y). We expect focus on digitization under the two year turnaround strategy to yield a decline in C/I (excluding provisions) to 119.3% in FY2025 from 185.1% in FY2020.

Key data	
Target Price (KES)	3.79
Market price (KES)- 10/12/21	3.97
Downside	4.6%
No. of shares (mn)	384.6
Market Cap (KESmn)	1,526.9
Free float	24.7%
Dividend yield	0%

Major Shareholders	% of shares
Britam Holdings	19.41
Equity Nominees	12.70
Britam Life Assurance	15.99
StanChart Nominees	6.66
Others	40.49

YTD Change	19.5%
Min 52 weeks KES	4.99
Max 52 weeks KES	3.14

Price performance



Key Metrics	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
EPS	0.33	-1.54	-0.28	-4.40	-1.98	-2.49	-1.75	-1.41	-1.11
DPS	0.32	0	0.45	0.32	-	-	-	-	-
P/B	0.21	0.24	0.12	0.14	0.14	0.14	0.14	0.14	0.14
P/E	28.89	0	5.41	8.81	6.16	10.37	16.34	16.34	16.34
Div Yield	4.8%	5.7%	4.6%	4.8%	-	-	-	-	-
ROaE	1.1%	-5.5%	-1.1%	-18.2%	-9.0%	-11.3%	-7.9%	-6.4%	-5.0%
RoaA	0.2%	-0.9%	1.2%	-3.1%	-1.4%	-1.7%	-1.2%	-0.9%	-0.7%
C/I Ratio (excl. provisions)	91.1%	120.3%	104.2%	185.1%	146.9%	164.0%	134.6%	126.1%	119.3%

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FINANCIAL HIGHLIGHTS

HF's after tax loss for 3Q2021 eased to a loss of KES 569.9 million from a loss position of KES 730.2 million in 3Q2020. The improvement in bottom-line performance was primarily driven by higher non-funded income and lower operating expenses.

a) Lower Net Interest Income

Net interest income fell by 14.8% y/y to KES 1.4 billion (3Q2020: KES 1.6 billion) weighed by an 18.4% y/y decrease in interest income to KES 3.0 billion which offset the 21.2% y/y decline in interest expenses to KES 1.6 billion. Income from loans and advances dropped (-23.1% y/y to KES 2.5 billion) while income from government securities grew (+22.5% y/y to KES 479.9 million). Loan and advances fell by 7.9% y/y to KES 34.6 billion. We expect net loans advanced to rise to KES 39.3 billion in FY2025 with a CAGR of 3.8%, higher than the historical 5 year CAGR of -9.3%. We expect net interest income to edge up to KES 2.5 billion by FY2025.

b) Growth in Non-Funded Income

Non-funded income edged up by 12.2% y/y to KES 453.4 million (3Q2020: KES 404.2 million). The increase was mainly supported by growth in income from fees and commissions on loans and advances (+88.5% y/y to KES 98.2 million) and foreign exchange trading income (+30.8% y/y to KES 72.3 million). Non-funded income contribution to operating income rose to 24.7% from 20.0% in 3Q2020). We expect continued growth of the bank's non-funded income driven by the bank's digitization strategy. We expect NFI contribution to grow from 26.0% in FY2020 to 38.4% by FY2025.

c) Lower Customer Deposits

Customer deposits declined by 1.3% y/y to KES 37.5 billion. We note that the cost of customer deposits remains high at 3.9% in 3Q2021, however this is an improvement from 4.9% in 3Q2020. We expect the cost of customer deposits to ease to 3.6% in FY2025 from 4.5% in FY2020.

d) Lower Operating Expenses

Operating expenses (excluding provisions) improved by 2.9% y/y to KES 2.2 billion driven by a decline in other expenses (-8.2% y/y to KES 925.5 million). Loan loss provisions eased by 61.5% y/y to KES 169.7 million. The cost-to-income ratio excluding provisions however rose to 119.4% in 3Q2021 owing to a decline in operating income (-9.4% y/y to KES 1.8 billion). We note with concern the high C/I ratio. We expect the bank's focus on digitization to support efficiency and see the C/I ratio ease to 119.3% in FY2021 from 185.1% in FY2020.

HF FINANCIALS

Income Statement (KES Mn)	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Interest Income	7,133	6,046	5,167	4,266	4,086	3,858	4,421	4,592	4,765
Interest Expense	4,156	3,780	3,149	2,399	2,224	2,261	2,281	2,299	2,317
Net Interest Income	2,976	2,266	2,018	1,866	1,862	1,597	2,140	2,423	2,217
Total Non-Interest Income	1,346	1,319	1,353	513	912	1,000	1,134	1,203	1,248
Total Operating Income	3,747	3,209	3,371	1,974	3,132	3,444	3,560	3,475	3,460
Loan Impairment Provisions	-576	-376	-299	-405	-376	-394	-409	-425	-441
Operating Expenses	-3,412	-3,861	-3,511	-3,653	-3,520	-3,613	-3,857	-3,871	-3,883
Pre-Tax Profit(Loss)	312	-643	-138	-1,776	-1,121	-1,408	-989	-798	-626
Income Tax Expense	185	-45	-28	-69	-353	-443	-332	-252	-197
Net Profit(Loss)	126	-598	-110	-1,706	-768	-965	-678	-547	-429

Balance Sheet (KES Mn)	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Government securities	2,287	3,212	4,602	7,106	7,518	7,972	8,413	8,489	8,812
Loans and Advances (Net)	49,369	43,186	38,552	36,797	33,927	35,319	36,497	37,883	39,323
Total Assets	67,541	60,549	56,455	55,445	59,311	57,525	59,999	60,866	62,038
Equity									
Total Equity	11,450	10,371	10,192	8,562	11,471	10,506	9,829	9,282	8,853
Liabilities									
Customer Deposits	36,661	34,721	37,400	39,945	42,261	44,290	45,973	47,720	49,533
Total Equity & Liabilities	67,541	60,549	56,455	55,445	59,311	57,525	59,999	60,866	62,038

Indicators	2017	2018	2019	2020	2021F	2022F	2023F	2024F	2025F
Non-Interest Income to Total Operating Income	35.94%	41.11%	40.13%	25.97%	38.03%	45.38%	39.58%	39.17%	38.35%
Cost to Income Ratio(Excl. Provisions)	91.07%	120.31%	104.15%	185.11%	146.86%	164.02%	134.61%	126.07%	119.28%
Return on Average Equity	1.11%	-5.48%	-1.07%	-18.20%	-8.97%	-11.27%	-7.92%	-6.39%	-5.00%
Return on Average Assets	0.18%	-0.93%	-0.19%	-3.05%	-1.37%	-1.69%	-1.17%	-0.92%	-0.70%

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Glossary of Terms

Net Interest Margin (NIM) - Net interest margin is a measure of the difference between interest paid and interest received, adjusted for the total amount of interest-generating assets held by the bank. It is calculated as: $\text{Net Interest Income} / \text{Average Interest Earning Assets}$

Basis points (bps) – one hundredth of a percentage i.e. $1.0\% = 100\text{bps}$ or $1\text{bps} = 0.01\%$

Target price – Analyst estimate of the fair value or intrinsic value of the company

Cost of Funds-This is the effective average interest rate paid on interest earning liabilities. It is calculated as $\text{Total Interest Expense} / \text{Average Interest Earning Liabilities}$

Loan Yield- This is the effective average interest rate received on average loans and advances. It is calculated as $\text{Interest on Loans and Advances} / \text{Average Loans and Advances}$

Cost of Risk – This ratio measures the amount of risk involved in lending. It is calculated as: $\text{Net Impairment Provisions} / \text{Average Gross Loans in the period}$

Non-performing loans-These are loans that have been classified as impaired. The CBK classifies loans into five categories i.e. Normal, Watch, Substandard, Doubtful and Loss depending on performance of the loan. The last three i.e. sub-standard, doubtful and loss are referred to as non-performing loans. Under IFRS, these classified as stage 3 loans.

Non-performing loans (NPL) Ratio - This is the proportion of NPLs in the loan book. It is calculated as $\text{Gross NPLs} / \text{Gross Loans}$

Non-funded/Non-Interest Income– This represents the income that is not classified as interest income.

Non-Funded/Non-Interest Income Ratio. This represents the proportion of total operating income that is not classified as interest income. It is calculated as $\text{Non-Interest Income} / \text{Total Operating Income}$

Composite market share (Market share Index) - This is a weighted composite index comprising of assets, deposits, capital size, number of deposit and loan accounts. The composite market share is used by CBK to classify banks into three groups:

- Tier 1(Large Size Bank); Composite market share of 5.0% and above
- Tier 2(Medium Size Bank); Composite market share of between 1.0% and 5.0%
- Tier 3(Small size Bank); Composite market share of less than 1.0%

Recommendation

BUY – Minimal risks to catalysts

SELL- Risks outweigh the catalysts

NEUTRAL – This is where the positives and negatives in a company almost balance out. You can accumulate for the long term.



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