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HOUSING FINANCE (HF): FY2012 RESULTS NOTE

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RECOMMENDATION:	NEUTRAL
Rating	2
Current Price-22.02.13	17.80
Target Price (KES)	20.49
Upside Potential	15.1%

Share Statistics

Issued Shares (Mn)	230
Market Cap (KES Mn)	4,609
Market Cap (USD Mn)	52.64
Free Float	38.90%

Source: NSE

Summary

Following the release of HF's FY2012 results, we revise our earlier rating from BUY to a **NEUTRAL recommendation** on the stock, with a **price target of KES 20.49**, based on P/B multiple. This represents a 15.1% upside potential based on the prevailing market price of KES 17.80. We note that the stock has rallied from 15.10 (during our earlier recommendation) to the current price level.

Key results highlight include the following:

- **Interest income growth, in line with our forecasts:** The reported total interest income grew by 46.3% from KES 3.5 billion in FY2011 to KES 5.1 billion in FY2012 (compared to our forecasted growth of 45.5% to KES 5.0 billion).
- **High cost of funds (8.9% in FY2012 from 5.9% in FY2011):** The total interest expense rose by 99.6% (compared to our forecast of 97.5%) from KES 1.6 billion in FY2011 to KES 3.1 billion in FY2012. This was pushed up by rising interest rates, pushing the average cost of funds for HF from 5.9% (FY2011) to 8.9% (FY2012)
- **Increase in OpeX 4.6% higher than forecasted:** The total operating expenses (OpeX) rose by 9.4% from KES 1.0 billion (FY2011) to KES 1.1 billion (FY2012). This was 4.6% (KES 47 million) more than we had anticipated

Outlook

- **Political risk:** Stakeholders, potential customers and other participants in the real estate sector are maintaining a wait-and-see attitude due the current political uncertainties ahead of the general election on March 4, 2013
- **Declining interest rates:** Under low interest rate environment, we expect HF to boost its loan book. Additionally, we expect the decline in interest rates to ease pressure on the firm's cost of deposits
- **Partnerships & Joint Ventures:** Housing Finance plans to partner with various stakeholders in the real estate, including and not limited to developers, joint ventures and the government

Year to 31 Dec	2011A	2012F	2013F
Net Income (Kshs '000)	622,279	743,334	809,379
EPS (Kshs)	2.70	3.23	3.51
BVPS (Kshs)	20.5	22.3	25.7
P/E x	6.59	5.52	5.07
P/B x	0.9	0.8	0.7
ROE	13.2%	14.5%	13.7%
ROA	2.0%	1.8%	1.7%
C/I Ratio	47.0%	50.5%	48.2%

Source: Company reports, FIB Estimates

Housing Finance FY2012 Income statement (KES '000)	FY2011	FY2012	% change
Interest income	3,464,079	5,068,815	46.3%
Interest expenses	1,562,517	3,118,780	99.6%
Net interest income	1,901,562	1,950,035	2.5%
Non-interest income	291,619	283,887	-2.7%
Total operating income	**2,193,181**	**2,233,922**	**1.9%**
Operating expenses	1,031,089	1,128,525	9.4%
Loan loss provision	186,297	197,766	6.2%
Profit Before Tax	**975,795**	**907,631**	**-7.0%**
Profit After Tax	**622,278**	**743,334**	**19.5%**
EPS	***2.70***	***3.23***	
Interest income yield	***11.3%***	***13.4%***	
Average cost of funds	***5.9%***	***8.9%***	
ROE	***13.2%***	***14.5%***	

Source: Company Release

Housing Finance FY2012 Balance Sheet (Kshs '000)	FY2011	FY2012	% change
Loan book	28,821,683	30,293,711	*5.1%*
Government securities	401,331	723,616	*80.3%*
Available for sale investments	-	-	
Total liabilities	33,197,284	35,819,332	*7.9%*
Customer deposits	*24,004,584*	*22,937,649*	*-4.4%*
Shareholders' funds	**4,796,937**	**5,137,245**	*7.1%*
Capital adequacy ratio	***29.5%***	***29.5%***	
Core capital/total risk weighted assets	***18.8%***	***19.1%***	
Liquidity ratio	***30.30%***	***36.80%***	

Source: Company Release

Results largely in line with our forecasts

Housing Finance (HF) released its FY2012 financial results, which were largely in line with our forecasts carried in our Banking Sector Report 2012 dubbed 'The Innovation Imperative' (released on October 25, 2012).

PBT dropped by 7.0% to KES 908 million

The profit before tax (PBT) declined by 7.0% from KES 976 million in FY2011 to KES 908 million in FY2012 (against our forecast of a 2% increase to KES 978 million in FY2012).

PAT grew by 19.5% to KES 743 million, mainly due to a lower interest expense

Profit after tax (PAT) grew by 19.5% from KES 622 million in FY2011 to KES 743 million in FY2012 (compared to our forecast of KES 646 million, 3.8% increase).

The variance was widened by the reduction in interest expense. This was due to the impact of a combination of KES 75 million (relating to deferred tax asset from impairment provisions disallowed for corporation tax purposes in prior periods) and KES 52.6 million deferred tax on accumulated tax losses on KBS).

Key Results Highlights

46.3% growth in interest income in line with our forecast

Interest income driven by high interest rate environment combined with a 5.1% growth in loans

Interest income growth, in line with forecasts: The reported total interest income grew by 46.3% from KES 3.5 billion in FY2011 to KES 5.1 billion in FY2012 (compared to our forecasted growth of 45.5% to KES 5.0 billion). The growth in interest income was mainly driven by the high interest rate environment (especially during 1H2012) combined with a 5.1% increase in the loan book (to KES 30.3 billion).

The average interest income yield on mortgage loans rose from 11.5% (FY2011) to 14.2% (FY2012). This resulted in a 47.3% increase in interest income on mortgages (vis-a-viz our forecast of 44.2%).

Investment in government securities mainly in 3Q2012 and 4Q2012

The interest income on government securities rose by 74.4% to KES 63 million, mainly due to an 80.3% increase in government securities to KES 724 million between 3Q2012 and 4Q2012. Investments in government securities, over the preceding 2 quarters were fairly flat, with the company starting to increase investments from 3Q2012. 1Q2012 was still characterized by a high interest rate environment with the benchmark 91-day Treasury bill at above 17.0%.

38.8% increase in interest income on deposits with other banks

The interest income on deposits and placements with other banking institutions rose by 38.8% to KES 717 million (compared to our forecast of 797 million). Yield on these deposits averaged 10.7%, a 0.3% increase from 10.4% in FY2011. We had estimated that the yield could rise to 16.5%, owing to the high interest rate environment.

Rise in average cost of funds from 5.9% to 8.9%

High cost of funds (8.9% in FY2012 from 5.9% in FY2011): The total interest expense rose by 99.6% (compared to our forecast of 97.5%) from KES 1.6 billion in FY2011 to KES 3.1 billion in FY2012. This was pushed up by rising interest rates, pushing the average cost of funds for HF from 5.9% (FY2011) to 8.9% (FY2012).

The interest expense on customer deposits rose from 170.2% from KES 850 million (FY2011) to 2.3 billion (FY2012). As a result, cost of mobilizing customer deposits more than doubled to stand at 10.0% (compared to our estimate of 9.5%) during the year under review.

9.4% increase in OpeX

Increase in OpeX 4.6% higher than forecasted: The total operating expenses (OpeX) rose by 9.4% from KES 1.0 billion (FY2011) to KES 1.1 billion (FY2012). This was 4.6% (KES 47 million) more than we had anticipated. The main drivers of the rise in operating expenses were staff costs (+13.8% to KES 684 million), rental charges (+49.5% to KES 20 million, due to opening of new branches), depreciation (+30.4% to KES 61 million).

Rise in C/I ratio from 47.0% to 50.5%

The rise in OpeX negatively impacted on HF's operating efficiency, with the cost/income (C/I) ratio rising from 47.0% (FY2011) to 50.5% (FY2012). However, we believe this provides a bottom-line enhancement opportunity, where the company is able to manage costs.

Loan loss provision up 6.2%

6.2% increase in loan loss provisions: The loan loss provision increased from KES 186 million (FY2011) to KES 198 million (FY2012). This was necessitated by a 47.6% increase in gross non-performing loans from KES 1.6 billion (FY2011) to KES 2.3 billion (FY2012).

Slight deterioration in capital adequacy ratios

Slight deterioration in capital adequacy ratios: Key capital adequacy ratios deteriorated. The core capital/total deposit liabilities dropped from 19.9% (FY2011) to 18.2% (FY2012), core capital/total risk weighted assets dropped from 21.4% to 19.1% and the total capital/total risk weighted assets dropped from 34.0% to 29.5%. More importantly, the ratios are still well above the mandatory capital requirements stipulated by the Central Bank of Kenya.

Outlook

Political risk still a concern

- **Political risk:** Stakeholders, potential customers and other participants in the real estate sector are maintaining a wait-and-see attitude due the current political uncertainties ahead of the general election on March 4, 2013. This has a negative impact on developments and investments in the sector, as projects/investments undertaken are long-term. However, we anticipate that regardless of what happens, the situation can not be as bad as it was after the 2007 elections. Reforms continue to take place under the new constitution including judiciary reforms as well as police reforms.

Interest rates expected to decline

- **Declining interest rates:** 2H2012 was characterized by declining interest rates. The benchmark 91-day T-bill closed the year at 8.30% from a high of 20.6% in January 2012. The long term expectation is that interest rates will continue to drop. Under low interest rate environment, we expect HF to boost its loan book. Additionally, we expect the decline in interest rates to ease pressure on the firms cost of deposits

Increasing sources of external balance sheet funding

- **External cheap funding sources:** During the year under review, HF was able to access USD 20 million from International Finance Corporation (IFC). The IFC funding is expected to spur the market for environmentally friendly housing in the country.

  In addition, Kenya Building Society (KBS), the property development subsidiary of HF, is expected to initiate additional capital raising initiatives from 1H2013. In our view, access to cheap sources of funds has been a bottleneck in the firm's ability to significantly grow its earnings.

Current accounts to stir deposit mobilization

- **Current accounts:** We expect HF to be able to marshal increasing amounts of customer deposits, now that they were allowed to operate current accounts.

- **Partnerships & Joint Ventures:** Housing Finance plans to partner with various stakeholders in the real estate market, including and not limited to developers, joint ventures and the government. In FY2012, the firm invested about KES 87 million in joint ventures.

It has so far entered into joint ventures at the Precious Gardens development (which plans to put up 328 apartments), Kahawa joint ventures.

HF plans to complete Komarock 5A and launch Komarock 6. We expect rolling out of more development projects, with the reviving of KBS.