

Below is a summary of HF Group H1'2024 performance:

Balance Sheet Items (Kshs bn)	H1'2023	H1'2024	y/y change
Net loans	38.1	37.9	(0.4%)
Government Securities	9.8	12.2	24.4%
<b>Total Assets</b>	<b>60.7</b>	<b>63.7</b>	<b>5.0%</b>
Customer Deposits	40.7	45.0	10.7%
Deposits Per Branch	1.6	1.6	0.0%
Total Liabilities	51.9	54.4	5.0%
<b>Shareholder's Funds</b>	<b>8.9</b>	<b>9.3</b>	<b>5.2%</b>

Balance Sheet Ratios	H1'2023	H1'2024	% y/y change
Loan to deposit ratio	93.5%	84.2%	(9.3%)
Government Securities to deposit ratio	24.1%	27.1%	3.0%
Return on Average Equity	4.7%	5.2%	0.5%
Return on Average Assets	0.7%	0.8%	0.1%

Income Statement (Kshs bn)	H1'2023	H1'2024	y/y change
Net Interest Income	1.27	1.33	4.7%
Net non-Interest Income	0.5	0.7	30.7%
<b>Total Operating income</b>	<b>1.8</b>	<b>2.0</b>	<b>12.5%</b>
Loan Loss provision	(0.2)	(0.2)	5.3%
Total Operating expenses	(1.6)	(1.8)	8.9%
Profit before tax	0.2	0.3	41.7%
<b>Profit after tax</b>	<b>0.2</b>	<b>0.3</b>	<b>46.3%</b>
<b>Core EPS</b>	<b>1.0</b>	<b>1.4</b>	<b>45.3%</b>

Income Statement Ratios	H1'2023	H1'2024	y/y change
Yield from interest-earning assets	10.0%	6.1%	(3.8%)
Cost of funding	4.9%	3.6%	(1.3%)
Net Interest Spread	5.1%	2.6%	(2.5%)
Net Interest Margin	5.2%	2.7%	(2.5%)
Cost of Risk	8.7%	8.2%	(0.6%)
Net Interest Income as % of operating income	69.9%	65.0%	(4.9%)
Non-Funded Income as a % of operating income	30.1%	35.0%	4.9%
Cost to Income Ratio (with LLP)	89.0%	86.2%	(2.8%)
Cost to Income Ratio (without LLP)	80.3%	78.0%	(2.3%)

Capital Adequacy Ratios	H1'2023	H1'2024	% points change
Core Capital/Total Liabilities	6.7%	4.5%	(2.2%)
Minimum Statutory ratio	8.0%	8.0%	0.0%
<b>Excess</b>	<b>(1.3%)</b>	<b>(3.5%)</b>	<b>(2.2%)</b>
Core Capital/Total Risk Weighted Assets	7.2%	5.2%	(2.0%)
Minimum Statutory ratio	10.5%	10.5%	0.0%
<b>Excess</b>	<b>(3.3%)</b>	<b>(5.3%)</b>	<b>(2.0%)</b>
Total Capital/Total Risk Weighted Assets	11.0%	8.8%	(2.2%)
Minimum Statutory ratio	14.5%	14.5%	0.0%
<b>Excess</b>	<b>(3.5%)</b>	<b>(5.7%)</b>	<b>(2.2%)</b>
Liquidity Ratio	24.7%	24.9%	0.2%
Minimum Statutory ratio	20.0%	20.0%	0.0%
<b>Excess</b>	<b>4.7%</b>	<b>4.9%</b>	<b>0.2%</b>

### Income Statement

- Core earnings per share increased by 45.3% to Kshs 1.4 from Kshs 1.0 in H1'2023, mainly driven by the 12.5% growth in total operating income to Kshs 2.0 bn, from Kshs 1.8 bn in H1'2023. However, the performance was weighed down by an 8.9% growth in total operating expenses to Kshs 1.8 bn, from Kshs 1.6 bn in H1'2023,
- The 12.5% growth in total operating income was mainly driven by a 4.7% growth in Net Interest Income to Kshs 1.33 bn, from Kshs 1.27 bn in H1'2023, coupled with a 30.7% growth in Non funded Income (NFI) to Kshs 0.7 bn, from Kshs 0.5 bn in H1'2023,
- Interest income grew by 23.8% to Kshs 3.0 bn from Kshs 2.5 bn in H1'2023, mainly driven by a 23.2% growth in interest income from loans and advances to Kshs 2.3 bn from Kshs 1.9 bn in H1'2023, coupled with 21.1% growth in interest from government securities to Kshs 0.7 bn, from Kshs 0.6 bn in H1'2023. As such, the Yield on Interest-Earning Assets (YIEA) increased to 11.7% from 10.0% recorded in H1'2023, mainly attributable to the faster 23.8% growth in interest income compared to a 6.3% increase in average interest earning assets to Kshs 49.6 bn, from Kshs 46.6 bn in H1'2023,
- Interest expense increased by 44.4% to Kshs 1.7 bn in H1'2024 from Kshs 1.2 bn in H1'2023, largely due to a 87.3% increase in interest expense on customer deposits to Kshs 1.3 bn from Kshs 0.7 bn in H1'2023, coupled with 66.5% increase in interest expenses on deposits and placements to Kshs 0.2 bn from Kshs 0.1 bn in H1'2023. Consequently, Cost of funds (COF) increased by 1.7% points to 6.7% from 4.9% recorded in H1'2023, owing to a faster 41.6% increase in Trailing interest expense to Kshs 3.2 bn, from Kshs 2.2 bn recorded in H1'2023, compared to a 4.5% increase in average interest bearing liabilities to Kshs 47.8 bn from Kshs 45.7 bn in H1'2023. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. On the other hand, Net Interest Margin (NIM) increased marginally to 5.3% from 5.2% in H1'2023, attributable to the faster 8.3% increase in trailing Net Interest Income (NII) to Kshs 2.6 bn from Kshs 2.4 bn in H1'2023 relative to the 6.3% increase in average interest earning assets to Kshs 49.6 bn, from Kshs 46.6 bn in H1'2023,
- Non-Funded Income (NFI) increased by 30.7% to Kshs 0.7 bn from Kshs 0.5 bn in H1'2023, mainly driven by a 38.3% increase in the other fees to Kshs 0.2 bn from Kshs 0.1 bn in H1'2023. The revenue mix shifted to 65:35, from 70:30 in H1'2023 for the Funded to Non-funded income owing to the faster increase in NFI by 30.7%, compared to the 23.8% increase in NII.
- Total operating expenses increased by 8.9% to Kshs 1.8 bn from Kshs 1.6 bn in H1'2023, driven by 5.3% increase in loan loss provisions to Kshs 0.17 bn from Kshs 0.16 bn recorded in H1'2023, coupled with an 18.1% increase in staff costs to Kshs 0.9 bn from Kshs 0.7 bn in H1'2023.
- Cost to Income Ratio (CIR) decreased to 86.2% from 89.0% in H1'2023, owing to the 12.5% increase in total operating income, which outpaced the 8.9% increase in total operating expenses. Notably, CIR without LLP decreased by 2.3% points to 78.0% from 80.3% recorded in H1'2023, and,
- Profit before tax increased by 41.7% to Kshs 0.3 bn from Kshs 0.2 bn in H1'2023. Similarly, profit after tax increased by 46.3% to Kshs 0.3 bn in H1'2024, from Kshs 0.2 bn in H1'2023.

### Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 5.0% to Kshs 63.7 bn, from Kshs 60.7 bn in H1'2023, mainly attributable to the 24.4% growth in government securities to Kshs 12.2 bn in H1'2024 from Kshs 9.8 bn in H1'2023, but weighed down by a 0.4% decrease in net loans to Kshs 37.9 bn, from Kshs 38.1 bn recorded in H1'2023
- Total liabilities grew by 5.0% to Kshs 54.4 bn, from Kshs 51.9 bn in H1'2023, largely attributable to a 10.7% growth in customer deposits to Kshs 45.0 bn in H1'2024, from Kshs 40.7 bn in H1'2023. Borrowings declined by 25.9% to Kshs 3.1 bn from Kshs 4.2 bn in H1'2023.

- The faster 10.7% growth in customer deposits as compared to the 0.4% decline in loans led to a decrease in the loan to deposits ratio to 84.2%, from 93.5% in H1'2023,
- Gross Non-Performing Loans (NPLs) increased by 6.3% to Kshs 11.2 bn in H1'2024 from Kshs 10.5 bn in H1'2023, while Gross Loans increased by 1.6% to Kshs 46.4 bn from Kshs 45.6 bn in H1'2023. Consequently, the asset quality deteriorated with the NPL ratio rising to 24.2% in H1'2024 from 23.1% in H1'2023,
- General Provisions (LLP) increased by 13.6% to Kshs 5.1 bn in H1'2024 from Kshs 4.5 bn in H1'2023. The NPL coverage increased to 75.6% in H1'2024, from 72.0% in H1'2023, attributable to the 6.3% increase in gross non-performing loans which offset the 5.3% increase in provisions coupled with 8.6% increase in interest in suspense to Kshs 3.4 bn from 3.1 bn recorded in H1'2023.
- Shareholders' funds increased by 5.2% to Kshs 9.3 bn in H1'2024, from Kshs 8.9 bn in H1'2023. Notably, accumulated losses increased by 8.3% to Kshs 3.3 bn, from Kshs 3.0 bn in H1'2023,
- HF Group remained under-capitalized with a core capital to risk-weighted assets ratio of 5.2%, 5.3% points below the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 8.8%, 5.7% points below the statutory requirement of 14.5%, and,
- The bank currently has a Return on Average Assets (ROaA) of 0.8%, and a Return on Average Equity (ROaE) of 5.2%.

**Key Take-Outs:**

1. **Strong earnings growth** - Core earnings per share increased by 45.3% to Kshs 1.4 from Kshs 1.0 in H1'2023, mainly driven by the 12.5% growth in total operating income to Kshs 2.0 bn, from Kshs 1.8 bn in H1'2023.
2. **Asset quality deterioration** – The bank's gross NPL ratio increased to 24.2% in H1'2024 from 23.1% in H1'2023, attributable to the faster growth of 6.3% in Gross non-performing loans to Kshs 11.2 bn in H1'2024 from Kshs 10.5 bn in H1'2023, which outpaced the 1.6% increase in gross loans to Kshs 46.4 bn, from Kshs 45.6 bn recorded in H1'2023,
3. **Sustained Efficiency** – Cost to Income Ratio (CIR) decreased to 86.2% from 89.0% in H1'2023, owing to the 12.5% increase in total operating income, which outpaced the 8.9% increase in total operating expenses. Notably, CIR without LLP decreased by 2.3% points to 78.0% from 80.3% recorded in H1'2023.

**Valuation Summary**

- We are of the view that HF Group is a "Sell" with a target price of Kshs 3.8 representing a downside of 15.0%, from the current price of Kshs 4.5 as of 23<sup>rd</sup> August 2024.
- HF Group is currently trading at a P/TBV of 0.2x and a P/E of 4.2x vs an industry average of 0.8x and 4.0x respectively.