

Below is a summary of HF Group Q3'2024 performance:

Balance Sheet Items (Kshs bn)	Q3'2023	Q3'2024	y/y change
Net loans	38.5	38.2	(0.7%)
Government Securities	9.0	13.2	45.5%
<b>Total Assets</b>	<b>60.7</b>	<b>65.6</b>	<b>8.0%</b>
Customer Deposits	43.8	45.0	2.7%
Deposits Per Branch	1.7	2.0	21.3%
Total Liabilities	52.0	56.2	8.1%
<b>Shareholder's Funds</b>	<b>8.7</b>	<b>9.4</b>	<b>7.8%</b>

Balance Sheet Ratios	Q3'2023	Q3'2024	% y/y change
Loan to deposit ratio	87.8%	84.9%	(2.9%)
Government Securities to deposit ratio	20.6%	29.2%	8.6%
Return on Average Equity	5.3%	7.0%	1.7%
Return on Average Assets	0.8%	1.0%	0.2%

Income Statement (Kshs bn)	Q3'2023	Q3'2024	y/y change
Net Interest Income	1.91	1.96	2.6%
Net non-Interest Income	0.9	1.0	10.9%
<b>Total Operating income</b>	<b>2.8</b>	<b>3.0</b>	<b>5.3%</b>
Loan Loss provision	(0.2)	(0.2)	5.0%
Total Operating expenses	(2.6)	(2.7)	3.9%
Profit before tax	0.3	0.3	18.9%
<b>Profit after tax</b>	<b>0.2</b>	<b>0.5</b>	<b>104.6%</b>
<b>Core EPS</b>	<b>0.6</b>	<b>1.3</b>	<b>104.6%</b>

Income Statement Ratios	Q3'2023	Q3'2024	y/y change
Yield from interest-earning assets	10.4%	11.6%	1.2%
Cost of funding	5.2%	6.8%	1.6%
Net Interest Spread	5.2%	4.8%	(0.5%)
Net Interest Margin	5.3%	5.0%	(0.3%)
Cost of Risk	8.4%	8.4%	(0.0%)
Net Interest Income as % of operating income	67.8%	66.1%	(1.7%)
Non-Funded Income as a % of operating income	32.2%	33.9%	1.7%
Cost to Income Ratio (with LLP)	90.7%	89.5%	(1.2%)
Cost to Income Ratio (without LLP)	82.3%	81.1%	(1.2%)

Capital Adequacy Ratios	Q3'2023	Q3'2024	% points change
Core Capital/Total Liabilities	5.1%	3.7%	(1.4%)
Minimum Statutory ratio	8.0%	8.0%	0.0%
<b>Excess</b>	<b>(2.9%)</b>	<b>(4.3%)</b>	<b>(1.4%)</b>
Core Capital/Total Risk Weighted Assets	5.8%	4.3%	(1.5%)
Minimum Statutory ratio	10.5%	10.5%	0.0%
<b>Excess</b>	<b>(4.7%)</b>	<b>(6.2%)</b>	<b>(1.5%)</b>
Total Capital/Total Risk Weighted Assets	9.6%	7.7%	(1.9%)
Minimum Statutory ratio	14.5%	14.5%	0.0%
<b>Excess</b>	<b>(4.9%)</b>	<b>(6.8%)</b>	<b>(1.9%)</b>
Liquidity Ratio	25.1%	26.1%	1.0%
Minimum Statutory ratio	20.0%	20.0%	0.0%
<b>Excess</b>	<b>5.1%</b>	<b>6.1%</b>	<b>1.0%</b>

### Income Statement

- Core earnings per share increased by 104.6% to Kshs 1.3 from Kshs 0.3 in Q3'2023, mainly driven by the 5.3% growth in total operating income to Kshs 3.0 bn, from Kshs 2.8 bn in Q3'2023 which outpaced the 1.9% growth in total operating expenses to Kshs 2.7 bn, from Kshs 2.6 bn in Q3'2023,
- The 5.3% growth in total operating income was mainly driven by a 2.6% growth in Net Interest Income to Kshs 1.96 bn, from Kshs 1.91 bn in Q3'2023, coupled with a 10.9% growth in Non Funded Income (NFI) to Kshs 1.0 bn, from Kshs 0.9 bn in Q3'2023,
- Interest income grew by 23.0% to Kshs 4.7 bn from Kshs 3.8 bn in Q3'2023, mainly driven by a 32.7% growth in interest income from government securities to Kshs 1.1 bn from Kshs 0.8 bn in Q3'2023, coupled with 19.6% growth in interest from loans and advances to Kshs 3.5 bn, from Kshs 2.9 bn in Q3'2023. As such, the Yield on Interest-Earning Assets (YIEA) increased to 11.6% from 10.4% recorded in Q3'2023, mainly attributable to the faster 23.8% growth in trailing interest income compared to a 11.5% increase in average interest earning assets to Kshs 52.4 bn, from Kshs 47.0 bn in Q3'2023,
- Interest expense increased by 43.6% to Kshs 2.7 bn in Q3'2024 from Kshs 1.9 bn in Q3'2023, largely due to a 86.6% increase in interest expense on deposits and placements by other institutions to Kshs 0.3 bn from Kshs 0.2 bn in Q3'2023, coupled with 48.4% increase in interest expenses on customer deposits to Kshs 2.1 bn from Kshs 1.4 bn in Q3'2023. Consequently, Cost of funds (COF) increased by 1.6% points to 6.8% from 5.2% recorded in Q3'2023, owing to a faster 44.1% increase in Trailing interest expense to Kshs 3.5 bn, from Kshs 2.4 bn recorded in Q3'2023, compared to a 9.7% increase in average interest bearing liabilities to Kshs 50.8 bn from Kshs 46.4 bn in Q3'2023. 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) decreased marginally to 5.3% from 5.0% in Q3'2023, attributable to the slower 4.2% increase in trailing Net Interest Income (NII) to Kshs 2.6 bn from Kshs 2.5 bn in Q3'2023 relative to the 11.5% increase in average interest earning assets to Kshs 52.4 bn, from Kshs 47.0 bn in Q3'2023,
- Non-Funded Income (NFI) increased by 10.9% to Kshs 1.0 bn from Kshs 0.9 bn in Q3'2023, mainly driven by a 41.9% increase in the other fees to Kshs 0.25 bn from Kshs 0.17 bn in Q3'2023. The revenue mix shifted to 66:34, from 68:32 in Q3'2023 for the Funded to Non-funded income owing to the faster increase in NFI by 10.9%, compared to the 2.6% increase in NII.
- Total operating expenses increased by 3.9% to Kshs 2.7 bn from Kshs 2.6 bn in Q3'2023, driven by 16.8% increase in staff costs to Kshs 1.4 bn from Kshs 1.2 bn recorded in Q3'2023, coupled with an 5.0% increase in loan loss provisions to Kshs 0.25 bn from Kshs 0.24 bn in Q3'2023.
- Cost to Income Ratio (CIR) decreased to 89.5% from 90.7% in Q3'2023, owing to the 5.3% increase in total operating income, which outpaced the 3.9% increase in total operating expenses. Notably, CIR without LLP decreased by 1.2% points to 81.1% from 82.3% recorded in Q3'2023, and,
- Profit before tax increased by 18.9% to Kshs 0.31 bn from Kshs 0.26 bn in Q3'2023 with effective tax rate decreasing significantly to (54.8%) in Q3'2024, from 10.1% in Q3'2023, leading to a 104.6% increase in profit after tax to Kshs 1.3 bn in Q3'2024, from Kshs 0.6 bn in Q3'2023.

### Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 8.0% to Kshs 65.6 bn, from Kshs 60.7 bn in Q3'2023, mainly attributable to the 45.5 growth in government securities to Kshs 13.2 bn in Q3'2024 from Kshs 9.0 bn in Q3'2023, but weighed down by a 0.7% decrease in net loans to Kshs 38.2 bn, from Kshs 38.5 bn recorded in Q3'2023

- Total liabilities grew by 8.1% to Kshs 56.2 bn, from Kshs 52.0 bn in Q3'2023, largely attributable to a 2.7% growth in customer deposits to Kshs 45.0 bn in Q3'2024, from Kshs 43.8 bn in Q3'2023. Borrowings declined by 27.2% to Kshs 3.0 bn from Kshs 4.1 bn in Q3'2023.
- The faster 2.7% growth in customer deposits as compared to the 0.7% decline in loans led to a decrease in the loan to deposits ratio to 84.9%, from 87.8% in Q3'2023,
- Gross Non-Performing Loans (NPLs) increased by 8.5% to Kshs 11.5 bn in Q3'2024 from Kshs 10.6 bn in Q3'2023, while Gross Loans increased by 1.4% to Kshs 46.9 bn from Kshs 46.3 bn in Q3'2023. Consequently, the asset quality deteriorated with the NPL ratio rising to 24.4% in Q3'2024 from 22.8% in Q3'2023,
- General Provisions (LLP) increased by 13.9% to Kshs 5.3 bn in Q3'2024 from Kshs 4.7 bn in Q3'2023. The NPL coverage increased to 76.1% in Q3'2024, from 74.0% in Q3'2023, attributable to the 8.5% increase in gross non-performing loans which offset the 13.9% increase in provisions coupled with 8.2% increase in interest in suspense to Kshs 3.4 bn from 3.2 bn recorded in Q3'2023.
- Shareholders' funds increased by 7.8% to Kshs 9.4 bn in Q3'2024, from Kshs 8.7 bn in Q3'2023. Notably, accumulated losses decreased marginally by 0.9% to Kshs 3.10 bn, from Kshs 3.13 bn in Q3'2023,
- HF Group remained under-capitalized with a core capital to risk-weighted assets ratio of 4.3%, 6.2% points below the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 7.7%, 6.8% points below the statutory requirement of 14.5%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.0%, and a Return on Average Equity (ROaE) of 7.0%.

#### **Key Take-Outs:**

1. **Strong earnings growth** - Core earnings per share increased by 104.6% to Kshs 1.3 from Kshs 0.3 in Q3'2023, mainly driven by the 5.3% growth in total operating income to Kshs 3.0 bn, from Kshs 2.8 bn in Q3'2023 which outpaced the 1.9% growth in total operating expenses to Kshs 2.7 bn, from Kshs 2.6 bn in Q3'2023.
2. **Asset quality deterioration** – The bank's gross NPL ratio increased to 24.4% in Q3'2024 from 22.8% in Q3'2023, attributable to the faster growth of 8.5% in Gross non-performing loans to Kshs 11.5 bn in Q3'2024 from Kshs 10.6 bn in Q3'2023, which outpaced the 1.4% increase in gross loans to Kshs 46.9 bn, from Kshs 46.3 bn recorded in Q3'2023,
3. **Sustained Efficiency** – Cost to Income Ratio (CIR) decreased to 89.5% from 90.7% in Q3'2023, owing to the 5.3% increase in total operating income, which outpaced the 3.9% increase in total operating expenses. Notably, CIR without LLP decreased by 1.2% points to 81.1% from 82.3% recorded in Q3'2023.

#### **Valuation Summary**

- We are of the view that HF Group is a "Buy" with a target price of Kshs 5.2 representing a downside of 30.5%, from the current price of Kshs 4.0 as of 29<sup>th</sup> November 2024.
- HF Group is currently trading at a P/TBV of 0.2x and a P/E of 4.0x vs an industry average of 0.9x and 4.1x respectively.