

Valuation Summary

- HF Group is currently trading at a P/B of 0.6x and a P/E of 5.3x
- We recommend a Sell for the HF Group stock with a target price of Kshs. 19.6 representing an downside of 3.1% from the current price of Kshs. 21.5

Key Highlights during the Quarter

- HF Group, through its development arm HFDI, completed the following projects: Komarock Phase 5B, Precious Heights Phase 1 and Kahawa Downs and K-Mall in Komarock
- The Group also broke ground for the construction of 1500 residential units in the Komarock Heights and Richland projects

Earnings Update:**Income Statement**

- Core EPS increased by 47.6% y/y to Kshs. 3.8 per share from Kshs. 2.5 per share in Q1'2015, driven by 30.8% growth in operating revenue, outpacing operating expenses growth of 15.2%
- Operating revenue grew by 30.8% to Kshs 1.2 bn in Q1'2016, compared to Kshs 0.95 bn in 2015 driven by a 28.0% increase in net interest income to Kshs. 1.0 bn from Kshs. 0.8 bn in Q1'2015 and a 43.5% increase in non-interest income,
- Non-interest income grew by 43.5% to Kshs. 241.8 mn, from Kshs 168.5 mn in Q1'2015, supported by other income growth which grew by 136.5%, comprising of property sales from the completed K-Mall, 500 units in Komarock 5B, Kahawa Downs and Precious Heights Phase 1. The current revenue mix stands at 81%:19% funded to non-funded income, respectively,
- Operating expenses increased by 15.2% to Kshs. 0.8 bn from Kshs 0.7 bn in Q1'2015, driven by (i) a reduction in the loan loss provision by 5.4% to Kshs 136.9 mn from Kshs. 144.7 mn in Q1'2015, and (ii) a reduction in staff costs by 3.6% to Kshs 248.8 mn from Kshs. 258.2 mn in Q1'2015. The slower expense growth resulted to a reduction in the cost to income ratio to 62.2% from 70.6% in Q1'2015, higher than the industry average, which is at 59.4%
- PAT growth came in at 47.8% y/y, to Kshs. 0.3 bn from Kshs. 0.2 bn compared to our projection of an 18.4% increase

Balance Sheet:

- Customer deposits increased by 23.6% y/y to Kshs 40.9 bn from Kshs. 33.1 bn in Q1'2015, compared to our growth projection of a 32.3% increase. Deposit growth outpaced loan growth, which grew by 12.1% to Kshs. 53.4 bn from Kshs. 47.7 bn in Q1'2015, resulting into a loan to deposit ratio of 130.8% from 144.2% in Q1'2015
- The bank recorded a 16.8% increase in the non-performing loans to Kshs 4.5 bn from Kshs. 3.8 bn in Q1'2015, leading to an increase in NPL ratio to 8.5% from 8.0% in Q1'2015
- The yield from the bank's interest earning assets stood at 14.8%, while the cost of funds came in at 8.7%, resulting in a net interest margin of 6.1%, from 5.7% in Q1'2015
- Total liabilities increased by 16.8% to Kshs 61.2 bn from Kshs. 52.4 bn in Q1'2015. Shareholders' funds increased by 8.8% y/y to Kshs 11.0 bn from Kshs. 10.1 bn in Q1'2015
- Return on equity increased to 12.3% from 12.2% in Q1'2015 against an industry average of 17.2%, while return on assets came in at 1.9% from 1.7% in 2014 against an industry average of 2.9%
- The bank is currently well capitalized with its total capital risk weighted ratio below the statutory requirement by 3.6%

Below is a summary of the key line items in the balance sheet and income statement.

Figures in Kshs billions unless otherwise stated

Balance Sheet	Q1'15A	Q1'16A	y/y change	Q1'16E	Projected change	y/y	Variance growth projection	in vs
Net Loans	47.7	53.4	12.1%	56.9	19.3%		(7.2%)	
Total Assets	62.5	72.2	15.5%	74.6	19.3%		(3.8%)	
Deposits	33.1	40.9	23.6%	43.7	32.3%		(8.7%)	
Borrowings	17.2	18.7	8.4%	19.1	10.8%		(2.4%)	
Total liabilities	52.4	61.2	16.8%	63.7	21.5%		(4.7%)	
Shareholders' Funds	10.1	11.0	8.8%	10.9	7.6%		1.1%	

Income Statement	Q1'15A	Q1'16A	y/y change	Q1'16E	Projected change	y/y	Variance growth projection	in vs
Net interest Income	0.8	1.0	28.0%	0.9	11.9%		16.1%	
Net non-interest income	0.2	0.2	43.5%	0.2	2.5%		41.0%	
Total Operating income	1.0	1.2	30.8%	1.0	10.2%		20.5%	
Loan loss provision	0.1	0.1	(5.4%)	0.2	13.9%		(19.3%)	
Total Operating expenses	0.7	0.8	15.2%	0.8	12.7%		2.5%	
Profit before tax	0.3	0.5	68.2%	0.3	4.3%		63.9%	
Profit after tax	0.2	0.3	47.8%	0.3	18.4%		29.4%	

Ratios	Q1'15A	Q1'16A
Loan to Deposit ratio	144.2%	130.8%
Return on average equity	12.2%	12.3%
Return on average assets	1.7%	1.9%
Yield on Interest Earning Assets	13.3%	14.8%
Cost of funding	7.6%	8.7%
Net Interest Margin	5.7%	6.1%
Cost to Income	70.6%	62.2%

Capital Adequacy Ratios	Q1'15A	Q1'16A
Core Capital/Total Liabilities	24.3%	19.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	16.3%	11.3%
Core Capital/Total Risk Weighted Assets	18.1%	15.4%
Minimum Statutory ratio	8.0%	10.5%
Excess	10.1%	4.9%
Total Capital/Total Risk Weighted Assets	21.5%	18.1%
Minimum Statutory ratio	12.0%	14.5%
Excess	9.5%	3.6%
Liquidity Ratio	28.3%	28.0%
Minimum Statutory ratio	20.0%	20.0%
Excess	8.3%	8.0%