

HF GROUP | RIGHTS ISSUE

HF Group is offering up to **1,153,842,504** new ordinary shares at the offer price of **KES 4.00 per share** seeking to raise **KES 4.62Bn**.

The Offer Price represents an **8.8%** discount to the volume weighted average of 4th November 2024.

The offer comprises of:

- 1. Rights Issue:** HF Group is offering a **2:1** entitlement issue priced at KES 4.00 per share. Existing shareholders receive an entitlement of 2 shares for every 1 share as at the record date 1st November 2024. The entitlement shares amount to a total of 769,228,336.
- 2. Additional Shares:** Shareholders may opt for additional shares (one or more additional shares for every 1 ordinary share held) at the offer price. The additional shares will amount to a total of 384,614,168.
- 3. Green Shoe Option:** There is a 30% green shoe option (346,152,751 shares), which could raise an additional **~KES 1.38Bn**, to address potential oversubscription.

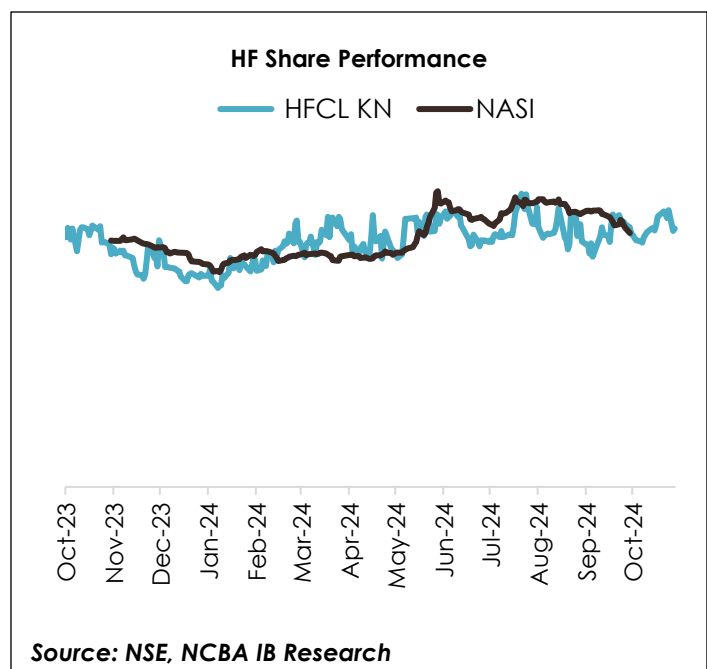
The Entitlement Shares are **renounceable**, which means that shareholders who do not wish to take up all or part of their entitlement can choose to abandon, sell or transfer them.

The New Shares will rank **pari passu** in all respects with the existing ordinary shares of the Group, ensuring equal rights and privileges, which should maintain shareholder value and minimize agency conflicts between new and existing shares.

The funds will support the Group's **growth** across **expanded business segments** and reinforce its capital base, ensuring regulatory compliance and financial stability.

The capital will also be directed toward enhancing the Group's **digital capabilities** aligning with industry trends toward digital transformation.

Share Data	HF Group Plc
Ticker	HFCL KN
RECOMMENDATION	BUY
Offer Price (KES)	4.00
Current Price (KES)	4.35
Target Price (KES)	5.31
Upside	22.1%
52WK High (KES)	5.20
52WK Low (KES)	2.80
No. of shares issued (Mn)	384.61
Market Cap (KES Bn)	1.67
EPS (HY'24 Annualized)	KES 2.76
P/E	1.6x
P/B	0.2x
Current Price = VWAP 4th November 2024	



HF GROUP: COMPANY OVERVIEW

HF Group Plc, previously known as Housing Finance, has transitioned from being a mortgage financier to a provider of integrated financial solutions with interests in Corporate, Business and Personal banking, Treasury, Trade Finance, and Bancassurance.

The Group has four operational subsidiaries:

- **HFC Limited** - licensed to carry out the business of mortgage finance as well as banking services under the Banking Act.
- **HF Development and Investment Limited** - (formerly known as Kenya Building Society Limited) undertakes property development and investment.
- **HF Bancassurance Intermediary Limited** - provides bancassurance solutions.
- **HF Foundation Limited** - The Group's social investment arm.

Shareholding Summary:

Major shareholders	No. of shares held	Percentage
Britam Holdings Plc	74,666,146	19.41%
Equity Nominees Limited A/C 00104	48,828,477	12.70%
Britam Life Assurance Company (Kenya) Ltd	61,488,083	15.99%
Permanent Secretary Treasury	9,265,135	2.41%
Kerai, Ramila Harji Mavji & Harji Mavji	7,202,000	1.87%
Musangi Andrew Mukite	6,400,000	1.66%
Mwangi Peter Kingori	6,094,289	1.58%
Bid Management Consultancy Limited	5,298,500	1.38%
Kibuwa Enterprises Limited	5,012,575	1.30%
Others	160,358,963	41.70%
Total	384,614,168	100.00%

Source: Company financials, NCBA IB Research

Britam Group, the majority shareholder, has confirmed that they will be taking up their full rights. Additionally, other principal shareholders have expressed their support for the transaction.

This commitment to fully take up its rights strengthens market confidence, suggesting endorsement of HF Group's strategic direction.

ANALYSIS OF THE OFFER

For Existing Shareholders: Participate or Sell and Exit?

Value proposition

- **Discount on offered shares:** A 5.5% discount on the offer price provides immediate value if the market price aligns with or further exceeds this discounted level.
- **Alignment with HF Group's growth:** Participating would allow the shareholder to maintain or increase their stake in HF Group's expected expansion in HFC Limited's diversified segments and digital initiatives. This expansion, if executed successfully, is expected to support capital appreciation and enhance long-term value.
- **Support from main shareholders:** With Britam taking up its full rights and other major shareholders endorsing the rights issue, the firm's strategic plan has support from key stakeholders.

Risks

- **Dilution risk:** Non-participating shareholders face a risk of dilution. If a shareholder neither exercises their rights nor purchases additional shares, their ownership percentage decreases. The renounceable structure, however, allows one to potentially monetize these rights.
- **Execution risk:** HF Group's expansion plan hinges on successfully deploying capital for digital growth and expansion in HFC Limited. If the strategy alters or does not achieve targeted returns, the shareholder may be exposed to negative growth in the share price.
- **Market volatility:** Given the broader economic environment, HF Group's share price is exposed to prevailing market conditions.

Selling and Exiting

- **Monetizing the rights:** There exists an option to sell off one's rights on the Nairobi Securities Exchange which could offer immediate cash flow while avoiding the dilution effect. For a client whose investment objectives favor stability over potential growth, exiting the stock could minimize exposure to the inherent risks of HF Group's capital deployment strategy.
- **Possible Long-Term Opportunity Loss:** Selling would mean foregoing the chance to benefit from HF Group's expansion if it is successful, potentially missing out on gains as the company builds its digital and segment-specific growth.

Recommendation

For shareholders with a risk tolerance aligned with HF Group's growth objectives, the rights issue provides an investment opportunity.

For more conservative investors, if they wish to minimize exposure to execution and market risks, selling could be a prudent approach.

For New Investors: Considering Entry via New Shares

Investment Case

- **Upside potential:** Current price offers an attractive entry point. On a trailing basis, HF is trading at a P/E multiple level of 1.5x against a peer average of 4.7x, a P/B multiple of 0.2x against a peer average of 0.6x.
- **Strategic growth and digital transformation:** With financial services increasingly favoring digital adoption, the Group's growth strategy could drive long-term capital appreciation successfully.
- **Green Shoe Option for Potential Upside:** The green shoe option is expected to absorb excess demand, thus reducing downward pressure on the share price.
- **Support by major shareholders:** Full participation by Britam and other major shareholders signals confidence in HF Group's strategy.

Investment Risk

- **Capital allocation and implementation risks:** HF Group's success in generating returns on the newly raised capital will be critical. Any missteps in execution could impact projected returns and subsequently, the share price.
- **Market dynamics:** New investors ought to weigh the effect of broader market dynamics on HF Group's valuation. Financial markets have shown volatility, especially in the financial services sector.
- **Entry discount vs. long-term value:** While the offer price includes a 5.5% discount, this value ought to be measured against the stock's actual performance post-offer.

Recommendation

For investors with a high and long-term risk tolerance, HF Group's rights issue offers an opportunity to buy at a discount and invest in a company aiming for strategic growth. The bank posted commendable results for the 1HY24.

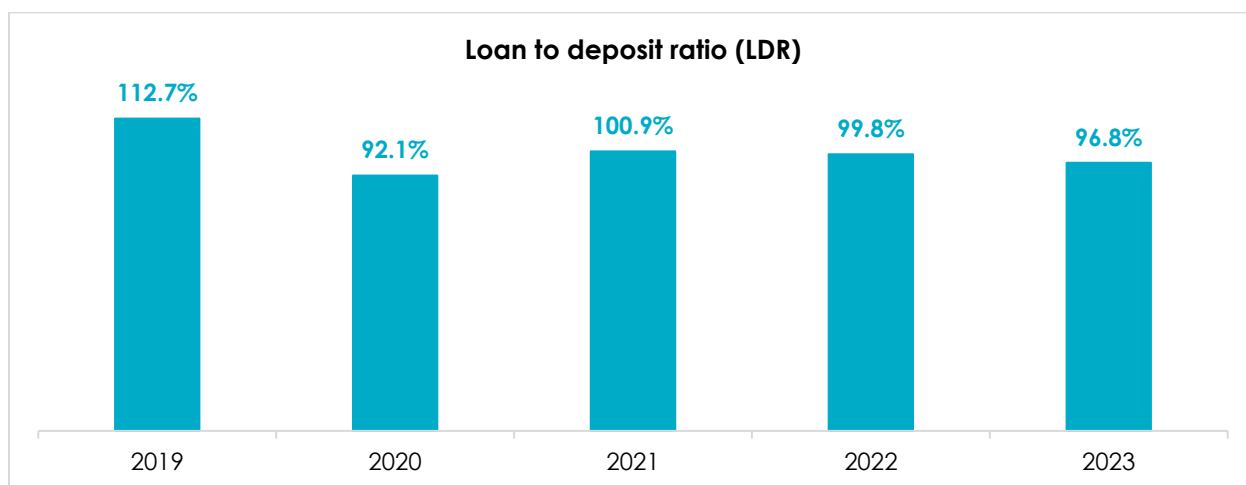
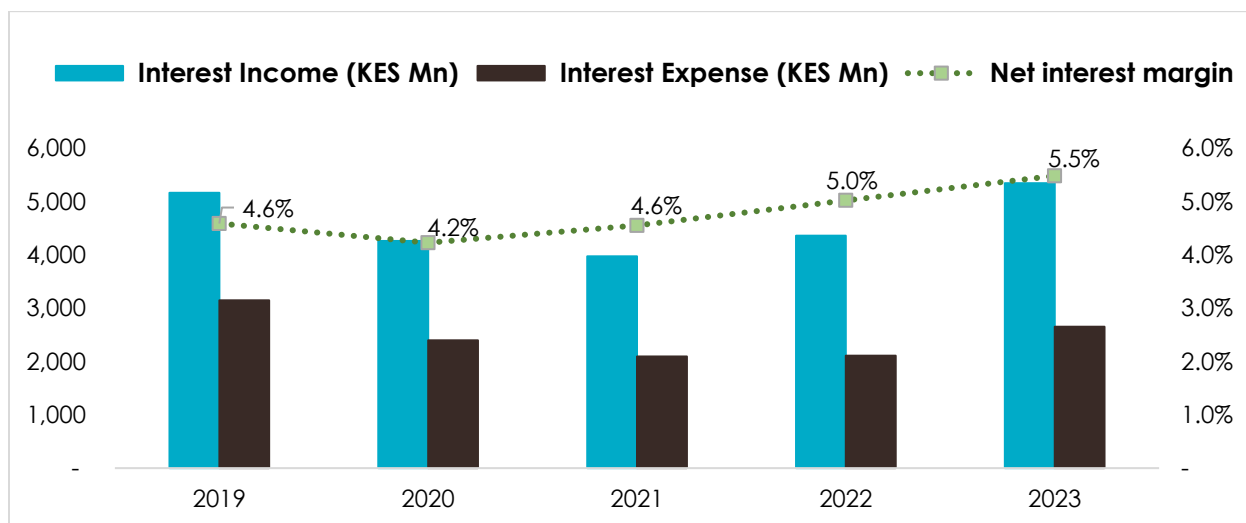
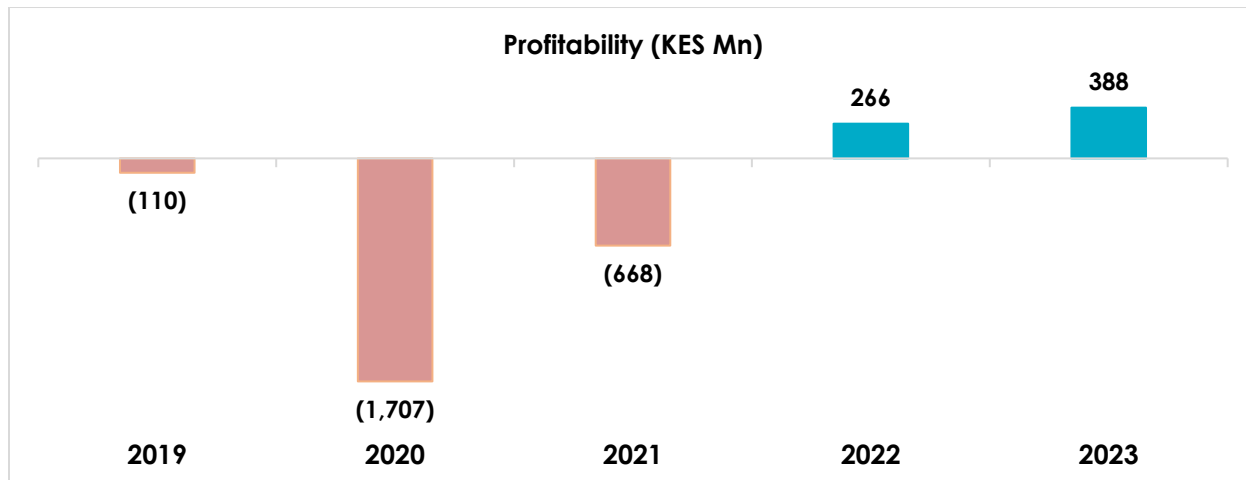
We expect HF Group to deliver profitability in FY2024 based on its focus on revenue diversification and digital transformation.

New investors may want to closely monitor HF Group's post-issue financial and operational performance to ensure the stock aligns with their portfolio goals, as the success of the expansion will be pivotal to the value derived from their entry point.

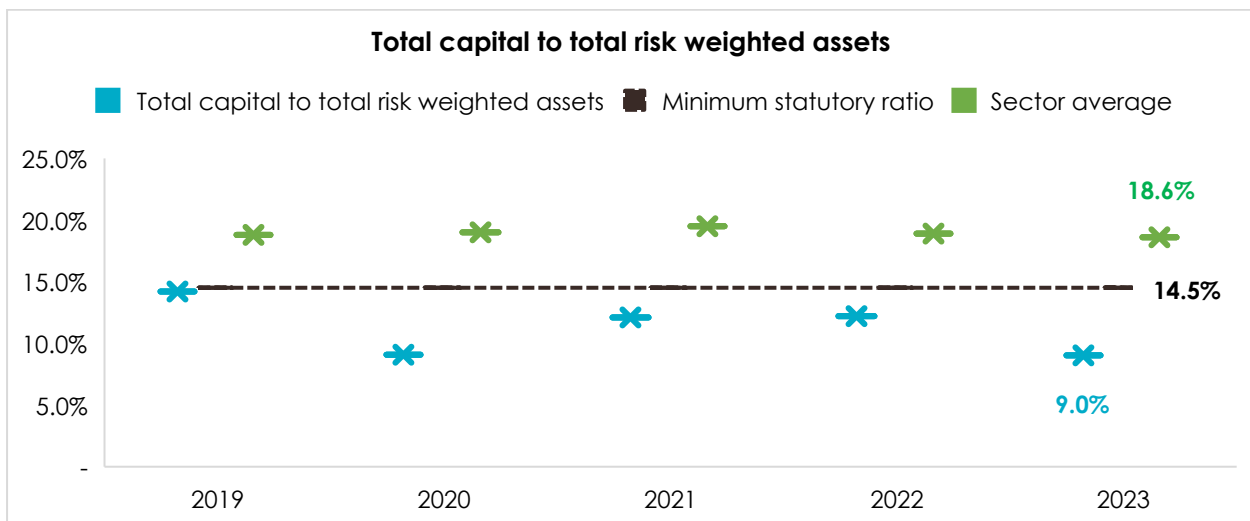
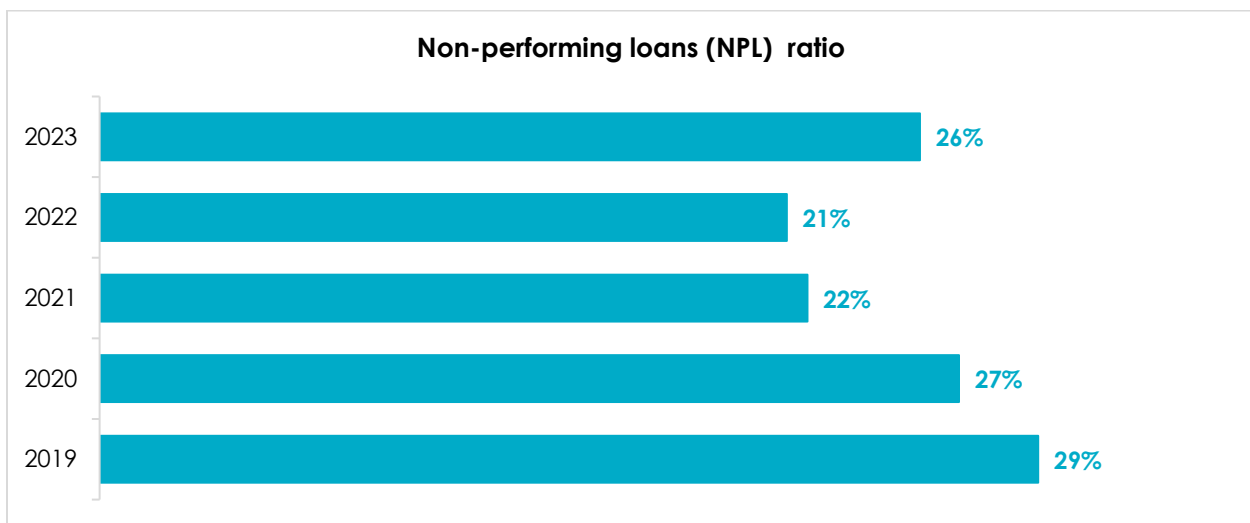
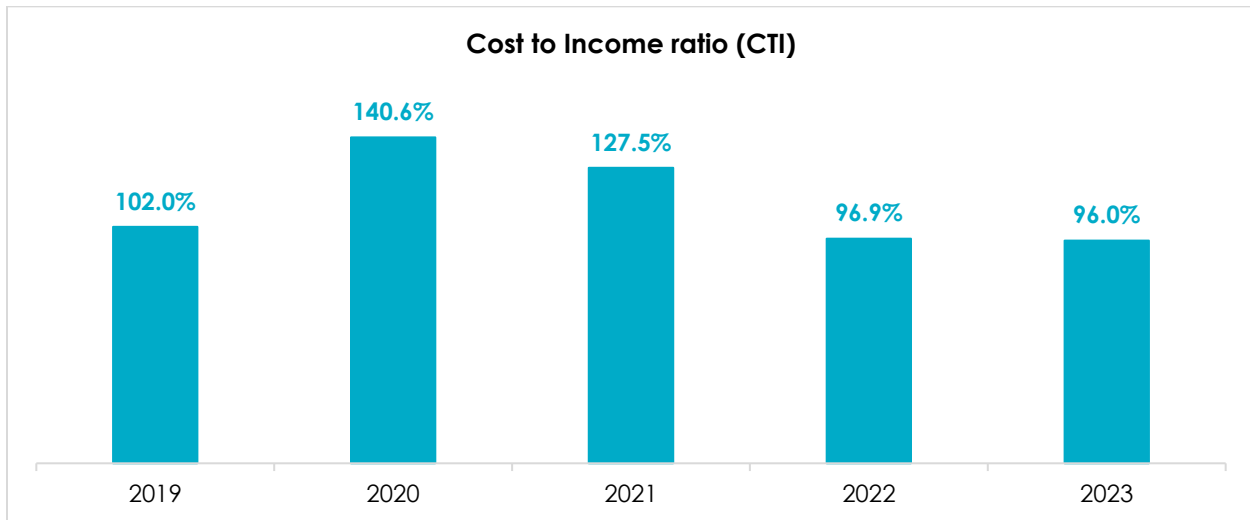
Rights Issue Statistics	Statistic
Par value	KES 5.00 each
Offer Price	KES 4.00 per share
Number of issued and paid up shares prior to the Rights Issue	384,614,168
Number of Entitlement Shares	769,228,336
Number of Additional Shares	384,614,168
Number of New Shares	1,153,842,504
Number of Green Shoe Option Shares	346,152,751
Number of New Shares plus Green Shoe Option shares	1,499,995,255
Number of issued and fully paid up shares post-Rights Issue assuming full subscription	1,538,456,672
Number of issued and fully paid up shares post-Rights Issue assuming full subscription and 100% uptake of the green shoe option	1,884,609,423
Gross proceeds of Rights Issue assuming full subscription	KES 4,615,370,016
Gross proceeds of Rights Issue assuming full subscription and 100% uptake of the green shoe option	KES 5,999,981,020

Timetable of Events	Date
Shareholder Approval for the Rights Issue at the Extra-Ordinary General Meeting	4th September 2024
CMA approval of the Information Memorandum	25th October 2024
Record Date	1st November 2024, 3pm
Upload of entitlement to CDS accounts	12th November 2024
Rights Issue Opens	12th November 2024, 9am
Commencement of trading of Rights on the NSE	12th November 2024
Last day of renunciation by way of private transfer / Last day for splitting (Private Transfer Renunciation Date)	2nd December 2024, 3pm
Last day for trading of nil paid Rights on the NSE	2nd December 2024, 3pm
Offer Close	9th December 2024, 5pm
Allocation	18th December 2024
Last date of payment of irrevocable bank guarantees	20th December 2024
Announcement of results	20th December 2024
Electronic crediting of CDS accounts with the New Shares	23rd December 2024
Dispatch of payment of refunds	23rd December 2024
Listing date and commencement of trading of New Shares on the NSE	24th December 2024

Financial Performance



Source: Company Financials, NCBA IB Research



Source: Company Financials, NCBA IB Research

Valuation and Investment Recommendation

From our estimates and assumptions based on **5-year financial forecasts**, we completed a comprehensive analysis to arrive at our fair value of the stock.

We arrived at a target price of **KES 5.31**, which implies a significant upside potential which reiterates our **BUY** recommendation. The target price implies an upside of **22.1%** to the current trading price of **KES 4.35** as of **4th November 2024**. Our estimate does not include the additional shares that will arise out of the rights issue.

We used four valuation methodologies to arrive at our fair value estimate:

1. Residual Income
2. Price to Book Valuation
3. Price to earnings Valuation

Assumptions

- Risk free rate of 15% based on the 10-year Treasury bond yields.
- Tax rate of 30%
- Country risk premium of 9.9% based on NYU Stern Country Risk Premium – Kenya.
- Adjusted Beta of 0.58 on stock's relative volatility on the index.
- Long term growth rate of 5% based on average GDP forecast.

Valuation Methodology	Implied Price	Weighting	Weighted Value
Residual Income Approach	6.3	40%	2.54
P/B Approach	4.4	40%	1.77
P/E Approach	5.1	20%	1.01
Fair Value		100%	5.31
Current Price (at 29.10.2024)			4.35
Upside/(Downside)			22.1%

Investment recommendation:

Going forward the bank will leverage on digitization to scale up retail business. The lender will continue to focus on executing its strategy to build a consumer banking business that is digitally enabled to drive reach and invest in areas of competitive strength.

The stock presents an opportunity for long-term investors to earn **capital gains**. We expect HF Group to deliver profitability in 2023 based on its focus on revenue diversification, cost rationalization and digital transformation.

APPENDIX: 1HY2024 Financial performance

Earnings: Net interest income grew by 4.7% to KES 1.3Bn, driven by interest income because of lending at higher rates during the period. Non-interest income grew by 30.7% to KES 716.3Mn driven by a 10.6% increase in FX income and a 17.7% rise in fee income.

Loan book: Loans and advances in the period declined by 0.4% to KES 37.9Bn while overall assets grew by 5.0% to KES 63.7Bn. Consequently, the loan to deposit ratio declined to 84.2% from 93.5% in the previous year. This mirrors the industry trend because of the prevailing macroeconomic conditions.

Customer deposits: Deposits from customers grew by 10.7% to KES 37.9Bn faster than the 0.4% decline in loans following deposit mobilization and retail business scale. The deposits, however, resulted in a 44.4% rise in interest expenses

Government Securities: Investments in government securities recorded a significant jump by 24.4% to KES 12.2Bn. This was attributable to the sovereign's elevated domestic interest rates supported by the 21.1% rise in interest income from government securities to KES 676Mn.

Efficiency: Cost to income ratio excluding provisions declined to 78.0% from 80.3% following cost optimization by the lender. Operating expenses rose by 8.9%, which is slower than the growth in revenues.

Asset Quality: The NPL ratio rose to 22.8% driven by the prevailing macro conditions in Kenya. The industry NPL went up to 16.3%. Provisions in the period grew by 5.3% bringing the NPL coverage to 45.7% due to prudent risk management.

HF Group	Key Metrics Y/Y
Loans and Advances	▼ (0.4%) to KES 37.9Bn
Customer Deposits	▲ 10.7% to KES 45.1Bn
Government Securities	▲ 24.4% to KES 12.2Bn
Net Interest Income	▲ 4.7% to KES 1.3Bn
Interest Income	▲ 23.8% to KES 3.1Bn
Interest Expense	▲ 44.4% to KES 1.7Bn
Non-interest income	▲ 30.7% to KES 716.3Mn
Forex trading income	▲ 10.6% to KES 91.5Mn
Loan Loss Provisions	▲ 5.3% to KES 167.4Mn
PAT	▲ 46.3% to KES 266.3Mn
EPS	▲ 45.3% to KES 1.4

Source: Company Financials, NCBA IB Research

HF Group	Key Ratios Y/Y
Loan Deposit ratio	▼ 84.2% from 93.5%
Net Interest Margin	▲ 2.1% from 2.0%
Cost of Funds	▲ 3.1% from 2.3%
Cost to Income	▲ 78.0% from 80.3%
Cost of Risk	▲ 0.4% from 0.4%
NPL Ratio	▲ 22.8% from 21.7%
Coverage Ratio	▲ 45.7% from 42.7%
ROE	▲ 2.9% from 2.1%
P/E	1.4x
P/B	0.2x

Source: Company Financials, NCBA IB Research

2024 Outlook

We expect HF Group to record steady growth boosted by:

- 1. Revenue Diversification:** Revenue streams such as commercial banking and business banking, which recorded a 3% increase in the previous year, should further scale the company towards being a fully-fledged financial services group.
- 2. Loans growth:** The lender's key focus on its established products, namely mortgages, will continue to record material year-on-year growth, especially with the implementation of the government affordable housing agenda.
- 3. Digital transformation:** The Fintech/digital capabilities of the Group continued to be strengthened by the successful rollout of the *HF Whizz app* which allows customers to make bill payments as well as get instant loans anytime, anywhere. This will increase the bank's transactional volumes and income.

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