FBN Holdings Plc.

Lackluster Performance Across Income Lines, PAT Down 18.64% q/q and 13.15% y/y

First Bank of Nigeria Holdings Plc (''FBNH'') released unaudited Q2-17 results yesterday, wherein gross earnings grew marginally by 4.63% (down 8.01% y/y and 66 bps below our estimate), while PBT and PAT contracted 22.50% q/q (-35.09% y/y) and 18.64% q/q (-13.15% y/y), respectively. The contraction in earnings broadly reflects poor performance across key line items; interest income grew slightly by 3.62% (57 bps below our estimate), while NIR declined 55 bps (-68.16% y/y) to miss our estimate by 7.99%. On the other hand, the impressive growth in net insurance premium (+126.56% q/q and 95.00% y/y) is worthy of note, albeit inconsequential to offset the sanguine performance of the major income line items.

NIR contracted marginally q/q, as significant declines in dividend income (-78.43% q/q and -56.22% y/y), net gains on foreign exchange income (-22.35%q/q and 95.75% y/y) – reflecting the limited leg-room for FX related gains in Q1 due to the relative stability of the NGN - and a net loss on investment securities offsets the slight improvement in net fee income (+1.96% and -0.84% y/y) and the surge in net gains on financial instruments (+149.21% q/q and -953.21% y/y) – due to impressive gains on derivative instruments.

The marginal growth in funding income reflects the decline in yields on the bank's portfolio of investment securities (-6.50% q/q), despite 11.08% growth in loans and advances to customers. In the same vein, interest expense rose 1.90% q/q (+46.26% y/y), attributable to the 14.26% growth in interbank placements, which was muted by the bank's improved deposit mix - with CASA share of deposits representing c.56% of total deposit.

Overall for H1-17, gross earnings rose 7.73% y/y (34 bps below our estimate), buoyed by impressive growth in interest income (+37.34% y/y) – translating to annualized asset yield expansion of 241 bps y/y to 12.11% – and net insurance premium (+56.91% y/y), offsetting the decline in NIR (-50.47% y/y and 3.07% q/q).

Interest expense (+58.27% y/y) rose significantly, largely due to the surge in borrowing expenses by 49.26% (total borrowings rose 14.83% y/y and 21.16% compared to FY-16 due to the N60.56 billion facility secured from AFDB in January 2017), translating to a 54 bps y/y expansion in annualized cost of funds to 2.94%. However, the impressive asset yield more than offsets the funding costs, resulting in 163bps NIM expansion to 8.83% (annualized).

Over H1-17, the asset quality deterioration rhetoric persisted. Despite 80 bps contraction in NPL to 22%, cost of risk remains elevated, rising 170 bps to 8.20% (annualized). Though provisioning declined 10.74 y/y, reflecting the 9.02% reduction in specific impairment, it rose 16.54% over Q2-17 due to the 17.57% q/q increase in specific impairment. However, noteworthy is the 75.89% y/y growth in net recoveries from loans previously written off, which we believe reflects the gradual improvements in the general commerce and manufacturing sectors from increased FX liquidity. FBNH reported CAR of 17.8% for the bank in FY-16 and 18.1% for Q1-17, relative to both periods CAR contracted to 17.6% in H1-17, though still largely above the required regulatory minimum of 16% for systemically important banks, the 50 bps contraction over Q2 leaves a lot to question.

SELL

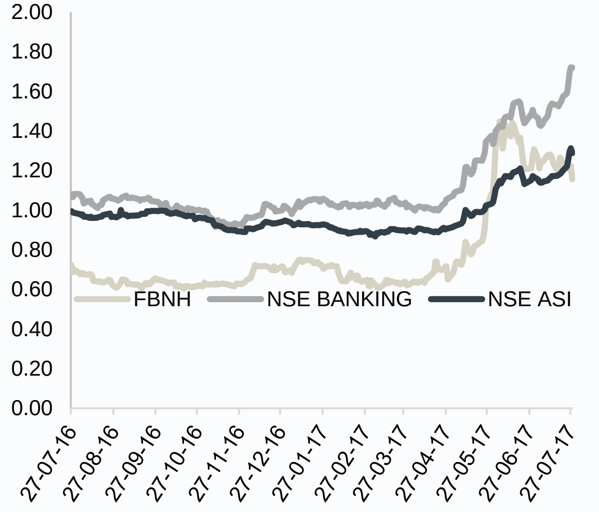
Target Price (N)*	5.37
Current Price (N)	5.97
Implied Return (%)	-10.09

Company Data	
NSE Code	FBNH
Bloomberg Code	FBNH:NL
Reuters Code	FBNH.LG
Sector	FINANCIAL SERVICES
Market Cap. (N'bn)	214.29
Free Float (%)	97.66

Ratios	H1-2017	H1-2016	2016FY
Assets Yield	12.1%	9.7%	11.7%
Cost of funds	2.9%	2.4%	2.8%
Net Interest Margin	8.8%	7.2%	8.8%
Cost of Risk	8.2%	6.5%	10.4%
Cost to Income	54.4%	47.4%	47.0%
Operational Leverage	4.8x	4.5x	5.0x
Liquidity Ratio	50.4%	55.9%	52.7%
CAR	17.6%	15.5%	17.8%
NPL/Total Loans	22.0%	22.8%	24.4%

*Under Review

Price movement (FBNH vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

Overall, operating income declined 2.58% y/y in H1 (-18.15% y/y and +5.26% q/q in Q2-17) 60 bps below our estimate. Gross opex rose 11.76% y/y (+9.38% y/y and 14.15% q/q in Q2-17) 2.88% above our estimate, following hikes in operating expenses (+22.98% y/y), insurance claims (+32.68%), and depreciation expenses (+6.15% y/y), while personnel expenses (-1.79% y/y) contracted marginally. Consequently, cost to income ratio and annualized operational leverage of 54.37% (47.39% in H-16) and 4.8x (4.5x in H1-16) beat our 52.53% and 4.6x estimates, respectively. Overall, PBT and PAT declined y/y by 22.36% and 17.76% y/y, respectively.

Parsing through the balance sheet, FBNH's loan book declined 3.75% y/y (+7.95% from FY-16 level), while the holding of investment securities increased 28.32% y/y (+11.79% from FY-16 level), not surprising, given the attractive yields on fixed income securities. On the other hand, deposits rose marginally by 2.06 y/y and 1.26% over FY-16 – largely driven by the 3.88% y/y growth in CASA deposits.

For the rest of 2017, we expect interest expense will remain elevated, as liquidity pressure (liquidity ratio was down to 50.4% in H1-2017, from 55.9% and 52.7% in H1-16 and FY-16, respectively) persists, and with the US Feds rate hike impact on the LIBOR further compounding the already stretched LCY interest rate. Although we expect the re-pricing of assets, higher yields on investment securities, and FX interest income to support NIM, risk asset creation will remain subdued as the bank takes strategic steps to clean its loan portfolio. On impairment charges, the bank's restructuring of some FCY obligations reflected in the contraction in NPL during the period, we expect this to contract further as the bulk of the upstream oil and gas reclassification reflects in the balance sheet, resulting in lower provisioning by FY-17 in line with our previous forecast.

Based on our last TP of N5.37, implying 10.09% downside from yesterday's close price of N5.97, we have a SELL recommendation on the stock. Our estimates are under review.

Highlight (N'Mn)	H1-2017	H1-2016	Y/Y	Cordros' Estimate	Variance	Q2-2017	Q1-2017	Q/Q	Cordros' Estimate	Variance
Gross Earnings	288,621	267,914	7.73%	289,608	-0.34%	147,573	141,048	4.63%	148,560	-0.66%
Interest Income	232,378	169,201	37.34%	233,055	-0.29%	118,253	114,125	3.62%	118,930	-0.57%
Interest Expense	(68,293)	(43,151)	58.27%	(68,075)	0.32%	(34,468)	(33,825)	1.90%	(34,250)	0.64%
Net Interest Income	164,085	126,050	30.17%	164,981	-0.54%	83,785	80,300	4.34%	84,681	-1.06%
Provisions	(62,408)	(69,914)	-10.74%	(73,748)	-15.38%	(33,587)	(28,821)	16.54%	(44,927)	-25.24%
NIP	5,509	3,511	56.91%	3,957	39.24%	3,822	1,687	126.56%	2,270	68.40%
NIR	44,828	90,548	-50.49%	46,769	-4.15%	22,352	22,476	-0.55%	24,293	-7.99%
Operating Income	214,422	220,109	-2.58%	215,706	-0.60%	109,959	104,463	5.26%	111,243	-1.15%
OPEX	(116,580)	(104,309)	11.76%	(113,311)	2.88%	(60,901)	(55,679)	9.38%	(57,632)	5.67%
PBT	35,628	45,886	-22.36%	28,647	24.37%	15,471	19,963	-22.50%	8,684	78.15%
Taxation	(6,142)	(10,031)	-38.77%	(6,709)	-8.45%	(2,330)	(3,812)	-38.88%	(2,897)	-19.57%
PAT	29,486	35,855	-17.76%	21,939	34.40%	13,141	16,151	-18.64%	5,788	127.06%

Disclosures.

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SELL (UNDERWEIGHT) - Over the next twelve months, we expect the stock to be more than 10% below the current market price.

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