

United Bank for Africa Plc.

First Glance: Consolidating on Stellar H1 Performance Amidst Opex Pressure

This afternoon, United Bank for Africa Plc (UBA) released 9M 2017 results, wherein key lines consolidated on the impressive performance in the first six months. Gross earnings grew by 25.75% (missed our estimate by 2.67%), driven by noteworthy growth across income lines – interest income (+30.11%, in line with our estimate) and non-interest revenue (+18.84%, 8.41% below our estimate). Accordingly, PBT and PAT grew by 27.24% and 16.55% respectively, but were both below our estimates by 12.58% and 14.79% respectively – reflecting the variance in NIR and opex – resulting in EPS of N1.74 (below our estimate of N1.82).

The growth in interest income was driven by improved yields on earning assets (+144 bps to 12.04%). Interest on loans and advances to customers and investment securities grew by 33.54% and 29.45% respectively. Accordingly, net interest margin expanded 197 bps to 7.6%, despite a 20.98% surge in interest expense (3.55% above our estimate).

While NIR grew double-digit, the variance from our estimates largely stemmed from significant q/q contraction in net trading income (-69.92% y/y). Generally, the growth was buoyed by improvement in net fee income (4.03% y/y), 41.30% y/y surge in net trading income (driven by FX and T'bills trading income), and growth in other income (79.38% y/y) due to relatively higher dividend income.

Opex rose 29.46% (8.22% above our estimate), following hikes across lines – other opex (+45.95% y/y), depreciation and amortization (+6.38% y/y), and personnel (+10.06% y/y). Noteworthy, the growth in other opex reflects the lagging impact of NGN devaluation on FCY related obligations, translation impact of subsidiaries' opex, and the higher AMCON levy (computed as 0.5% of total assets on a preceding year basis) relative to the same period in 2016. Consequently, cost to income ratio and annualized operational leverage of 61.50% (61.41% in 9M-16) and 5.1x (4.6x in H1-16) beat our 55.73% and 4.8x estimates respectively.

Specifically, on the performance in Q3-17, gross earnings contracted by 8.46% q/q (+11.25% y/y), driven largely by 38.60% q/q decline in NIR (+26.55% y/y), which muted the growth in interest income (6.33% q/q and 10.01% y/y). Accordingly, total operating income decline by 15.79% q/q (+12.01% y/y), with the impact on the bottom line further pressured by growth in opex (16.96% higher y/y but marginal on q/q basis). On the positive, credit loss provision moderated during the period by 45.28% q/q (52.31% above the level in previous year). Overall, PBT declined by double-digit (35.14 q/q, and 2.27% y/y) while a lower effective tax rate supported a marginal contraction in PAT (7.04%q/q and 5.39% y/y).

UBA recorded an additional N3.47 billion in credit loss provision in Q3-17, which raised total provision for 9M-17 to N12.91 billion (41.89% y/y), with a large proportion booked as specific charges – we believe this relates to the bank's exposure to the power sector – distribution companies (Ikeja & Eko Disco both in Lagos) and generating companies (Geregu, Shiroro, and Egbin) – and oil & gas sector. Overall, annualized cost of risk expanded by 131 bps y/y to 1.99%.

HOLD

Target Price (N)*	12.62
Current Price (N)	9.22
Implied Return (%)	36.87

Company Data

NSE Code	UBA
Bloomberg Code	UBA:NL
Reuters Code	UBA.LG
Sector	FINANCIAL SERVICES
Market Cap. (N'bn)	334.49
Free Float (%)	93.80

Ratios	9M-2017	9M-2016	2016FY
Yield on Assets	12.0%	10.6%	11.7%
Cost of Funds	3.7%	3.5%	3.7%
Net Interest Margin	7.6%	5.7%	6.7%
Cost of Risk	1.9%	0.7%	1.8%
Cost to Income	61.5%	61.4%	62.7%
CAR	19.7%	18.7%	19.7%
NPL/Total Loans	4.2%	2.5%	3.9%
Loan-to-Deposit Ratio	63.3%	61.7%	58.9%

*Under Review

Price movement (UBA vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

While noting the impressive performance over 9M-17, the contraction in NIR in Q3 – which supported gross earnings growth in Q2-17 – reflects the gradual squeeze in foreign exchange gains and the impact of the softening yield curve on held for trading securities, a trend that should persist over Q4. For 2017F, we expect gross earnings will close higher relative to 2016, given the current gains on FX related and derivative transactions, and yields on interest earning assets. However, the deterioration in asset quality portends a major risk to earnings outlook. Based on our last TP of N12.62, which is at 36.87% discount to the current market price of N9.22, we have a BUY recommendation on the stock. Our estimates are under review.

Highlight (N'Mn)	9M-2017	9M-2016	Y/Y	Cordros'		Q3-2017	Q2-2017	Q/Q	Cordros'	
				Estimate	Variance				Estimate	Variance
Gross Earnings	333,905	265,527	25.75%	343,072	-2.67%	111,187	121,469	-8.46%	127,527	-12.81%
Interest Income	238,092	182,989	30.11%	238,157	-0.03%	83,138	78,190	6.33%	86,502	-3.89%
Interest Expense	(85,795)	(70,916)	20.98%	(88,956)	-3.55%	(32,220)	(28,400)	13.45%	(33,330)	-3.33%
Net Interest Income	152,297	112,073	35.89%	149,200	2.08%	50,918	49,790	2.27%	53,172	-4.24%
NIR	84,603	71,191	18.84%	92,372	-8.41%	24,205	39,420	-38.60%	35,705	-32.21%
Operating Income	236,900	183,264	29.27%	241,573	-1.93%	75,123	89,210	-15.79%	88,877	-15.47%
Provisions	(12,909)	(9,098)	41.89%	(17,365)	-25.66%	(3,468)	(6,338)	-45.28%	(7,112)	-51.24%
OPEX	(145,699)	(112,540)	29.46%	(134,637)	8.22%	(50,895)	(50,781)	0.22%	(43,035)	18.26%
PBT	78,325	61,555	27.24%	89,599	-12.58%	20,794	32,061	-35.14%	38,730	-46.31%
Taxation	(17,405)	(9,286)	87.43%	(18,104)	-3.86%	(2,213)	(12,072)	-81.67%	(7,780)	-71.56%
PAT	60,920	52,269	16.55%	71,495	-14.79%	18,581	19,989	-7.04%	30,950	-39.96%

Disclosures.

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