

United Bank for Africa Plc.

Earnings to Outperform in FY-2017 Despite Downward Revision to Estimates

In its recently released Q3-17 results, UBA recorded decline in gross earnings (8.46% q/q), 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). However, over 9M-17, gross earnings grew by 25.75% (against our 29.20% y/y growth estimate), driven by growth across income lines – interest income (+30.11%, in line with our estimate) and non-interest revenue (+18.84%, below our 29.75% y/y growth estimate).

We have raised our gross earnings growth forecast slightly higher to 49.73% (previously 49.44%) in 2017F to N471.40 billion, on expected higher growth in interest income. That said, following an upward revision to our 2017F cost of funds, downward revision of NIR, and the expectation of a higher opex, we now forecast PBT and PAT growth of 66.29% and 13.24% (previously 74.51% and 14.28%) to N104.69 and N81.83 billion respectively. However, following the adjustment of our weighted average number of shares to reflect the complete cancellation of the 2.08 billion shares under the Staff Share Investment Trust scheme, our 2017F EPS is now 4.59% higher than previous estimate at N2.38.

We revise asset yield estimate for 2017F higher to 12.35% (previously 12.15%), on expected continued elevated yields on interest earning assets over Q4 (expanded 131 bps to 11.62% in 9M-17). Overall, we look for interest income growth of 27.25% (previously 22.18%) to N335.89 billion. On NIR, we believe the gains on FX trading (due to FX related gains and derivative transactions) and growth in fixed income securities trading will persist for the rest of the year. That said, we had earlier expected 24.9% growth in H2, but given the significant drop in Q3-17, we have revised growth estimate lower to 14.03% (previous 24.90% y/y), equating to N120.55 billion for 2017F.

On funding cost, we have reviewed our 2017F cost of funds estimate higher by 11 bps to 4.22%, translating to an interest expense growth of 31.24% (previously 27.82%) to N129.63 billion. Driving our upward revision is the surge in interest charge on borrowings – attributed to the bank's recently issued USD500 million Eurobond at a yield of 7.875% and a range of bilateral facility secured during the year – and Fed Rates hikes impact on LIBOR-linked borrowings. Note that these drove 39 bps rise in cost of funds to 3.88% in 9M-17. However, we believe the high yields on interest earning assets will outweigh the expansion in funding cost, thus, we estimate net interest margin to advance 118 bps to 7.48% (previously 7.02%).

In Q3-17, UBA made additional provisioning of N3.47 billion for credit loss, which raised total provision for 9M-17 to N12.91 billion, although the impact on cost of risk was masked by the 3.62% y/y growth in loan book. At 4.2% in 9M-17 (the same as H1-17), NPL was already ahead of 2017FY's c.4.00% guided by management. We maintain our 4.80% NPL forecast, but lower cost of risk estimate by 45 bps to 1.55% for 2017F, translating to additional provisioning of N11.92 billion for Q4 and total credit loss provision of N24.83 billion for 2017F.

The surge in opex in Q3-17 reflects the lagging impact of NGN devaluation on FCY related obligations, and translation impact of subsidiaries' opex. As such, we forecast 29.36% (previously 22.22%) growth in opex to N197.27 billion, translating to a 234 bps contraction in cost to income ratio to 60.37%, while we expect operational leverage to rise to 5.4x, compared to 4.9x in FY-16.

HOLD

Target Price (N)	10.14
Current Price (N)	9.00
Implied Return (%)	12.69

Company Data

NSE Code	UBA
Bloomberg Code	UBA:NL
Reuters Code	UBA.LG
Sector	FINANCIAL SERVICES
Market Cap. (N'bn)	307.79
Free Float (%)	99.50

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%

Price movement (UBA vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

While noting the (1) flattish growth in funding income over the last three quarters, (2) limited room for any significant growth in FX trading and revaluation gains with the relative stability of the naira, and (3) impact of the adoption of IFRS 9 from 2018F, we now expect PAT to grow lower than previously estimated over 2018-2019F, as FX related and revaluation gains taper and NIR contribution to gross earnings contract significantly.

Accordingly, we cut target price by 19.63% to N10.14 (previous: N12.62) and roll forward our valuation to 2018. Our current 12-month TP implies upside potential of 12.69% from current levels; consequently, we recommend a HOLD on the stock. UBA is currently trading at 2017F P/BVPS of 0.6x (below the peer average of 0.9x and 5-year average of 0.7x) and 2017 FP/E of 3.8x (below the peer average of 5.5x, but above the 5-year average of 3.2x).

Highlight (N'Mn)	Q1-2017A	Q2-2017A	H1-2017A	Q3-2017A	Q4-2017F	H2-2017F
Gross Earnings	101,249	121,469	222,718	111,187	129,139	240,326
Interest Income	76,764	78,190	154,954	83,138	89,444	172,582
Interest Expense	(25,175)	(28,400)	(53,575)	(32,220)	(36,462)	(68,682)
Net Interest Income	51,589	49,790	101,379	50,918	52,982	103,900
NIR	20,978	39,420	60,398	24,205	35,921	60,126
Operating Income	72,567	89,210	161,777	75,123	88,903	164,026
Provisions	(3,103)	(6,338)	(9,441)	(3,468)	(12,007)	(15,475)
OPEX	(44,023)	(50,781)	(94,804)	(50,895)	(52,544)	(103,439)
PBT	25,470	32,061	57,531	20,794	24,353	45,147
Taxation	(3,120)	(12,072)	(15,192)	(2,213)	(3,417)	(5,630)
PAT	22,350	19,989	42,339	18,581	20,937	39,518

Source: Company Accounts, Cordros Research

A – Actual

F – Forecast

Financial Statement (N'million).

Income Statement (N'M)	2015A	2016A	2017F	2018F	2019F	2020F	2021F
GROSS EARNINGS	314,830	383,647	472,141	506,186	486,077	525,241	558,695
Interest income	233,969	263,970	336,636	377,486	348,709	388,645	420,684
Interest expense	(96,030)	(98,770)	(130,127)	(136,640)	(139,009)	(146,489)	(157,530)
Net interest income	137,939	165,200	206,509	240,846	209,700	242,156	263,154
Non-interest income	72,304	105,689	120,522	112,470	120,161	118,164	117,528
Total Income	210,243	270,889	327,030	353,316	329,861	360,320	380,682
Total Operating Expenses	(136,626)	(152,501)	(197,562)	(204,847)	(183,382)	(197,819)	(212,798)
Net Operating Income	73,617	118,388	129,468	148,470	146,478	162,501	167,884
Loan impairment charges	(5,053)	(27,683)	(25,014)	(36,501)	(29,390)	(24,858)	(19,659)
Profit before Income tax	68,564	90,705	104,454	111,968	117,088	137,643	148,225
Income tax expense	(8,800)	(18,378)	(22,899)	(26,018)	(27,123)	(30,569)	(32,628)
Profit after Tax	59,764	72,327	81,555	85,950	89,965	107,074	115,597
Financial Position (N'M)	2015A	2016A	2017F	2018F	2019F	2020F	2021F
Cash and Cash Equivalents	655,371	760,930	835,637	825,448	901,700	956,253	1,077,007
Gross Loans	1,051,237	1,528,084	1,641,472	1,722,748	1,817,725	1,971,406	2,072,711
Other assets	40,488	37,849	40,138	45,032	49,544	55,740	43,080
Investment securities	856,870	970,392	1,120,809	1,212,238	1,317,008	1,375,670	1,479,905
Property and equipment	88,825	93,932	98,625	99,713	103,827	107,367	114,065
Total Assets	2,752,622	3,504,470	3,822,676	4,020,690	4,308,170	4,568,814	4,895,484
Interest Earning Assets	2,107,835	2,544,245	2,907,344	3,108,364	3,319,444	3,510,873	3,742,292
Total deposits	2,142,770	2,594,690	2,813,149	2,969,232	3,183,964	3,413,690	3,678,281
Other liabilities	54,885	110,596	104,104	113,398	94,526	109,593	125,052
Debt securities issued	85,620	85,978	88,422	70,265	65,725	74,616	58,799
Other borrowed funds	129,896	259,927	324,992	318,977	342,286	280,977	272,879
Total liabilities	2,420,001	3,056,401	3,336,673	3,478,482	3,692,408	3,886,260	4,140,810
Interest Bearing Liabilities	2,358,286	2,940,595	3,226,563	3,358,474	3,591,975	3,769,283	4,009,960
Statutory Reserve	65,450	73,866	84,176	89,573	94,827	105,113	116,220
Total equity	332,621	448,069	486,003	542,209	615,762	682,555	754,675
Key Ratios	2015A	2016A	2017F	2018F	2019F	2020F	2021F
EPS (N)	1.64	1.99	2.38	2.51	2.63	3.13	3.38
P/E (x)	1.93	3.26	4.25	4.04	3.86	3.24	3.00
BVPS (N)	9.17	12.35	14.21	15.85	18.01	19.96	22.07
P/BVPS (x)	0.35	0.53	0.71	0.64	0.56	0.51	0.46
Earnings yield	51.71%	30.64%	23.51%	24.78%	25.94%	30.87%	33.33%
Dividend Paid (N)	0.60	0.75	0.80	0.90	1.00	1.00	1.10
Dividend Yield	18.87%	11.54%	7.89%	8.87%	9.86%	9.86%	10.85%
RoAA	2.16%	2.31%	2.23%	2.19%	2.16%	2.41%	2.44%
RoAE	19.95%	18.51%	17.46%	16.72%	15.54%	16.49%	16.09%
Cost to income	64.98%	56.30%	60.41%	57.98%	55.59%	54.90%	55.90%
Operational Leverage	4.95	4.87	5.39	5.22	4.40	4.46	4.50
Yield on average earning assets	11.40%	11.35%	12.35%	12.55%	10.85%	11.38%	11.60%
Cost of interest bearing liabilities	4.01%	3.73%	4.22%	4.15%	4.00%	3.98%	4.05%
Net Interest Margin	6.72%	7.10%	7.10%	7.75%	6.32%	6.90%	7.03%
Cost of Risk	0.48%	1.85%	1.55%	2.16%	1.64%	1.28%	0.96%
LTD Ratio	49.06%	58.89%	58.35%	58.02%	57.09%	57.75%	56.35%
NPL Ratio	1.70%	3.90%	4.80%	5.20%	4.10%	3.80%	3.10%

Source: Company Accounts, Cordros Research

A – Actual, F – Forecast

Disclosures.

Analyst:

Oluwasegun Akinwale (*Oluwasegun.akinwale@cordros.com*)

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