

...Lessons learnt?

Equity Research | Earnings Update

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Analyst:
Wale Olusi
+234-8025672325
wale.olusi@unitedcapitalplcgroup.com

Risk Rating: Medium



Note: Refer to disclosure appendix for complete description of risk rating

Key Data

Last Price (₦)	7.30
52 week High/Low (₦)	9.0/4.0
1M Price Change (%)	2.8
3M Price Change (%)	-1.4
6M Price Change (%)	17.7
12M Price Change (%)	55.3
YTD Change (%)	2.1
Beta	1.5
Market Capitalization (₦'m)	262,035.6
Market Capitalization (\$'m)	691.4
Shares Outstanding. (Units'm)	35,895.3
Float (%)	97.0
12M Dividend Yield (%)	6.2

Price Performance Chart



Sources: Bloomberg, United Capital Research

Stock Rating
HOLD

Target Price
Old: N7.4
New: N7.1

Downside
-2.3%

FBN Holdings FY-2020 Earnings Update: Lessons Leant?

Earlier, FBN Holding Plc (“FBNH” or “The Bank”) released its FY-2020 results, showing a 1.9% y/y decline in Gross Earnings (GE) to N590.4bn. Hesitant top line growth was driven by weaker Interest income which fell 10.9% y/y to N384.8bn amid lower asset yields. Interestingly, PBT and PAT continued to improve, up 11.2% y/y and 14.5% y/y to N83.7bn and N75.6bn, respectively. Meanwhile, a N14.1bn Profit from discontinued operation, further bolstered bottom-line performance, bringing Profit for the year to N89.7bn. We review the financial performance and adjust our expectations for FY-2021 below.

Lower funding cost fails to offset significant pressure on asset yield:

FBNH’s weaker Gross Earnings growth was dragged by decline in Interest Income, even as Non-Interest Income (NII) surged 26.7% y/y. Unsurprisingly, lower asset yield (at 9.4% as at FY-2020 vs 11.5% in FY-2019), triggered by a dovish monetary policy environment in response to the pandemic resulted in a decrease in income from loans & advances, as well as investment securities during the period. Again, although interest expense reduced significantly (settling at N133.2bn vs. N152.3bn) on the back of lower cost of funds across board, this was unable to compensate for the reduction in Interest Income. As such, Net Interest Income fell 10.0% y/y to N251.6bn. Accordingly, Cost of Fund (CoF) and Net Interest Margin (NIM) both slid to 2.3% (from 3.1% prior) and 6.1% (from 7.4% prior).

Notably, improvement in NII, up 26.7% to N174.7bn, was supported by Fees and Comm. Income as well as a surge in Trading gains from investment securities from N17.5bn in FY-2019 to N48.1bn in FY-2020. This was traceable to trade related transactions, credit charges and letter of credit fees. Management had hinted that strong performance from its agency banking business supported non-interest income. Specifically, the bank reported that agent banking grew by over 100%, tallying at 86,000 agents across all local government areas in Nigeria, as well as expansion of the scheme to Ghana, DRC & Guinea.

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Profit profile bolstered by lower impairment losses: Interestingly, while loan loss expense had risen sharply as at H1-2020 to N30.7bn (vs N22.1bn in H1-2019), driven by translation impact of foreign currency loans and weak macro environment, audited FY-2020 result indicated that impairment losses reduced 1.0%y/y to N50.5bn. Thus, cost of risk slid to 2.4% in FY-2020 from 2.6% in FY-2019. According to the management, the impact of the COVID-19 pandemic on loan losses was muted due to benefit from the retooling of its risk management unit, a well-diversified loan book and under-exposure to sectors most devastated by Covid-19. Notwithstanding increase in general price level and FX devaluation, Cost-to-Income ratio slowed to 68.6% (vs. 69.7% in 2019). Clearly, Operating income grew faster, up 2.1% y/y, relative to 0.5% y/y expansion in Operating expenses, mainly due to muted growth in staff cost which rose by 4.9% y/y. Supported by surprisingly muted growth in loan losses and cost containment, PBT jumped 11.8% to N83.7bn. Again, Post tax profit from continuing operation which improved by 14.5% y/y to N75.6bn was further enhanced by a N14.1bn gain on discontinued operations following the sales of 65.0% stake in FBN Insurance Ltd. during the period. As such, after tax ROE and ROA settled at 12.6% and 1.3% (vs. 12.4% and 1.3% previously) respectively.

Asset quality concerns well handled, Capital buffers enhanced: Net loans and advances rose 24.0% y/y to N3.2tn with credit origination traceable to trade finance activities and increased appetite in manufacturing, power, oil & gas and general commerce. Management insisted that exposure to sectors such as aviation and hospitality, which were affected the most by Covid-19, was limited. Accordingly, NPL ratio fell to 7.7% as legacy NPLs were contained to below 1.1%. While improvement in asset quality appears unusual in a pandemic year, based on developments in other jurisdictions within the continent, our most convincing rationalization is that efforts by the bank to rebuild its balance sheet, after the 2015/2016 episode of asset quality deterioration, appears to have prepared the bank for the 2020 economic turmoil which was triggered by the pandemic. Again, we recall that FBNH injected fresh Tier-1 capital into First Bank Ltd (the commercial banking division), to reinforce its capital positions during the year. This resulted in a 150bps increase in CAR of FBN Ltd to 17.0%. To achieve this, a 65% stake in FBN Insurance was divested. Meanwhile, CAR for the merchant banking division surged from 17.7% to 26.6%. Clearly, this supports our view that the bank has not only learnt from its recent experience but has also become smarter in managing subsequent crisis as a result. Overall, balance sheet position looks healthy amid sustained increase in customer deposits, up 21.8% y/y to N4.9tn. This puts net loans to deposits at 46.8%, suggesting that the bank is very liquid. Notably, to support its dollar liquidity, FBNH raised a Eurobond worth \$350m in 2020.

Contacts

Securities Trading
+234-1-280-7443
securities@unitedcapitalplcgroup.com

Asset Management
+234-1-277-7511
Assetmanagement@unitedcapitalplcgroup.com

Trustees
+234-1-280-7275
Trustees@unitedcapitalplcgroup.com

Investment Banking
+234-1-280-7583
InvestmentBanking@unitedcapitalplcgroup.com

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Outlook and valuation; Stellar NII and improved risk management framework brightens

prospect: We are of the view that the stellar non-interest income performance was supported by agent banking dominance, improvement in OPEX and benefit from improved risk management framework. More importantly, improved capital adequacy ratio, buoyed by divestment from the insurance business, looks good on the Bank, as it can better withstand the lingering impact of the Covid-19 pandemic. As such, we expect pre-tax profit and post tax profit to sustain uptrend in 2021 amid reversal in the yield environment which should bolster interest income. FBNH announced a final dividend N0.45/share, translating to a dividend yield of 6.2%. Compared to EPS of N2.45/share, this implies a pay-out ratio of 18.0% relative to an average pay-out of 17.0% in the last 3 years. As such, we expect pay-out in 2021 to maintain a similar trend. Notably, FBNH's PB and PE ratios settled 0.3x and 3.5x compared to peer (tier-1) average 0.4x and 2.8x respectively. As such, we place a HOLD rating on FBNH but revise our year end TP to N7.13, due to increased risk free rate as well as poor sentiment for riskier assets. Compared to the current price of N7.30/share this translates to an downside of -2.3%.

Contacts

Securities Trading

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Asset Management

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Assetmanage-
ment@unitedcapitalplcgroup.com

Trustees

+234-1-280-7275

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InvestmentBank-
ing@unitedcapitalplcgroup.com

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Financial Highlights (N'Mn)

Headlines	FY 2020	FY 2019	Change
Gross Earnings	578,947	590,299	-1.9%
Interest Income	384,798	431,934	-10.9%
Interest Expense	-133,183	-152,324	-12.6%
Net Interest Income	251,615	279,592	-10.0%
Impairment Write-Back/(Loss)	-50,596	-51,093	-1.9%
Non-Interest Income	174,703	137,882	26.7%
Operating Expenses	-292,501	-290,321	0.8%
Share of profit of associates	482	87	454.0%
Profit/Loss Before Tax	83,703	76,286	11.2%
Taxation	-8,111	-9,242	-12.2%
Profit/Loss After Tax	75,592	66,044	14.5%
	FY 2020	FY 2019	
Cash and Balances with Central Banks	1,631,730	1,025,325	59.1%
Total Loans & Advances	3,234,091	2,607,321	24.0%
Investment Securities	1,675,644	1,414,530	18.5%
Total Deposits	5,933,935	4,880,322	21.6%
Total Assets	7,689,028	6,203,526	23.9%
Net Assets	765,171	661,125	15.7%
Cost to Income Ratio	68.6%	67.4%	1.2%
Loan to Deposits	54.5%	53.4%	1.1%
Trailing 12M ROAE	10.6%	11.1%	-0.5%
Price (N)	7.3		
Trailing 12M EPS (N)	2.1		
BVPS (N)	21.3		
P/E (x)	3.4		
P/BV (x)	0.3		

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United Capital Research adopts a 3-tier recommendation system for assets under our coverage: Buy, Hold and Sell. These generic ratings are defined below:

Buy: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%). We consider this as the minimum return that may deserve our holding of a risk asset, like equity.

Hold: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater zero but less than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%).

Sell: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at December 31st is less than zero.

NR*: Please note that in addition to our three rating heads, we indicate stocks that we do not rate with NR; meaning Not-Rated. We may not rate a stock due to investment banking relationships, other sources of conflict of interests and other reasons which may from time to time prevent us from issuing a rating on the shares (or other instruments) of a company.

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Company	Disclosure
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Flour Mills of Nigeria Plc	g,h
FCMB Plc	h
Fidelity Bank Plc	g,h
Forte Oil Plc	g,h
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