



Rating	BUY
Price	₦1.92
FVE	₦2.92
52-week range	₦1.51 – ₦2.90
Market Cap. (₦Mn)	55,324
1-month Avg. Vol	11,777,230
Curr. PB	0.29x

FIDELITY.NL - Share Price Trend



Analyst(s)

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Click link below for initial view on Fidelity Bank

FY 2018 Initial View: Striking outing in 2018, topped with juicy dividends

Fidelity Bank Plc. (FIDELITY.NL)

Stock Report

Resounding our BUY call

- In our company update published in November (See report: [Our preferred Tier 2 Bank](#)), we guided to the strong fundamentals underpinning our preference for Fidelity as our top pick in the Tier 2 space. The recently released FY 2018 numbers justified our sense. For context, while the bank posted modest increase in interest income, stronger NIR and more importantly, lower loan loss provision in the period supported the decent earnings (+29% YoY to ₦22.9 billion) during the period. Specifically, aided by increased income on placements and investment securities, interest income rose 4.2% YoY to ₦153.7 billion. Further down, fee income stayed resilient over the year resulting in 9% YoY increase in NIR (₦31.8 billion). Lastly, given an improved economic landscape, Cost of Risk (CoR) moderated to a record low of 0.5% (-98 bps YoY) with loan loss provision declining 63% YoY to ₦4.2 billion.
- Although, recent share price pullback over the past weeks is not unrelated to a play out of the revised dividend payment, wherein shortly after publishing its FY 18 results with a DPS of ₦0.22, management revised the DPS lower to ₦0.11 with a press release. Irrespective, we maintain our **BUY** rating on Fidelity FVE of ₦2.92, as such, we believe current pricing presents an attractive entry.

Table 1: Comparable metrics over FY 18

	Fidelity	FCMB	Union Bank	Average
Net Interest Margin	5.80%	7.60%	6.60%	6.67%
Cost – Income - Ratio	71.10%	70.90%	82.90%	74.97%
Cost of Risk	0.50%	2.20%	-0.70%	0.67%
Non-performing loan ratio	5.70%	5.90%	8.70%	6.77%
Capital Adequacy Ratio	16.70%	15.80%	16.40%	16.30%
Return on Equity	11.60%	8.20%	8.20%	9.33%
Current P/B	0.29x	0.20x	0.91x	0.47x
CASA (as a % of deposits)	81.60%	70.00%	71.40%	74.30%

- Over 2019, we forecast EPS of ₦0.88 which is 11% higher than 2018 (~~₦0.79~~). Growth in earnings mainly reflects i) decline in funding cost (-90 bps YoY) coming from an improved deposit mix and lower rate environment (ii) and an increase in loan book. Fidelity trades at a current P/B of 0.29x, a premium to FCMB P/B of 0.20x which we believe is justified based on Fidelity ROE of 11.6% relative to FCMB's ROE of 8.2%.
- **Aggressive Loan growth...** The bank delivered impressive long growth over 2018, with focus on four key sectors Manufacturing (~~₦54.5~~ billion), Transport (~~₦24.5~~ billion), General Commerce (~~₦21~~ billion) and Oil & Gas services (~~₦26~~ billion). However, following our discussion with management, we were made to understand that on-lending arrangement with development financial institutions (like BOI and NEXIM) accounted for 27% of the growth recorded in the loan book over 2018. Which broadly justified the compressed NIM during the period, as interest on such facilities were granted at single digits while the bank only charged guarantee fees on others.
- Going into 2019, while management more than exceeded its guidance for loan growth over 2018, we believe the increased competition by banks to grow loans through similar facilities as guided by management will limit the legroom for any significant cheaper loan growth over 2019. As such, we estimate balance sheet driven loans to account for 80% of the banks loan growth over FY 19 with the remaining 20% emanating from on-lending facilities. Overall, we maintain our view of an 8% loan growth over 2019 which is at the lower bandwidth of management's guidance of 7.5% - 10%.
- **Lower funding cost to support NIM.** While our expectation of actual balance sheet driven loan growth suggests higher yields on loans, we expect the moderating yields in the domestic economy the neuter the impact. As a result, we forecast asset yields to contract further by 100 bps YoY. However, we expect funding cost to drop at a similar pace (-90 bps YoY) on the back of lower term deposits as management's retail strategy further consolidates growth in deposit (+15%, management guidance: +10% YoY) over 2019 with CASA balancing at 83% (+170 bps YoY). On balance, NIM should expand at a modest pace of 10 bps YoY. Accordingly, we estimate a 5% increase in interest income (~~₦161.9~~ billion) while interest expense is expected to decline by 2.5% YoY to ~~₦82~~ billion. On balance, Net Interest Income should expand 14.9% YoY to ~~₦69.6~~ billion.
- **Strong fee income but lower NIR.** Going into 2019, we expect net fee income to expand 19% YoY to ₦20.3 billion still on the back of increased transactions on the bank's digital

platforms. However, we estimate FX gains to print sizably lower owing to our expectation of stable FX over the year. This translates to a 60% YoY decline on Other Operating income (₦4.5 billion). Overall, we expect NIR to print lower at ₦28.8 billion (-10% YoY).

- **Capital preservation on forefront.** The major challenges for the bank are its exposure to the Oil & Gas (Downstream) and Transport sector. Although, the bank has made significant provision on these exposures, we do not see much improvement given the nature of the sectors. Hence, we forecast absolute NPL to moderate only 1% YoY with NPL ratio printing at 5.3% (-40 bps YoY). Elsewhere, we estimate CoR to increase slightly by 20 bps YoY to 0.7%. Overall, our assumptions imply an impairment charge of ₦6.8 billion (+60% YoY).
- On dividend payment, with no expectation of tier 2 capital raise, management plans to maintain its CAR with the usual capitalization of profit. We attempt a scenario analysis¹ showing possible dividend payments for FY 2019 and the respective impact on the bank's CAR. As a result, we choose to be conservative and maintain a 17% payout ratio for 2019 which translates to a DPS of ₦0.15 and dividend yield of 8% based on current price.
- **Modest outlook for earnings growth.** Elsewhere, we forecast a slight increase of 2.6% YoY in OPEX with CIR expected to moderate by 307 bps YoY to 68%. At its conference call, management highlighted that the impact of the backdating of the AMCON levy which amounts to be ₦2 billion has been accounted for in the FY 18 financials. Net impact of our changes translates to a PBT and PAT of ₦27.9 billion (+11.5% YoY) and ₦36.1 billion (+11.1% YoY) respectively.
- Post adjustment, we maintain our FVE of ₦2.92 translating to a **BUY** recommendation. Fidelity trades at a forward P/B of 0.40x, a premium to its current P/B and FCMB forward P/B of 0.30x and 0.28x respectively. The higher P/B relative to FCMB is quite justified based on its higher ROE.

¹ See Table 2

Figure 1: Average yield on loan book across tier 2 banks

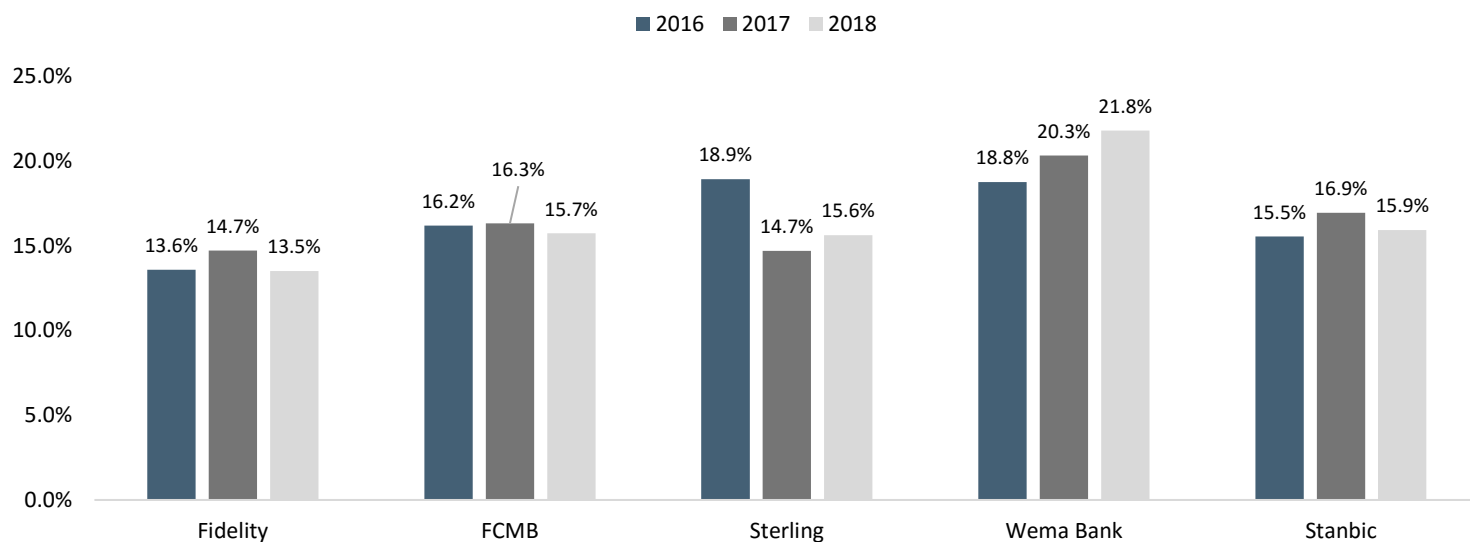


Table 2: Scenario analysis of dividend payment on Fidelity CAR

Payout Ratio	17%	20%	25%	30%	35%	40%	45%	50%
DPS (₦)	0.15	0.18	0.22	0.26	0.31	0.35	0.40	0.44
CAR	17.3%	17.2%	17.0%	16.8%	16.6%	16.3%	16.1%	15.9%

Figure 2: Interest Income breakdown

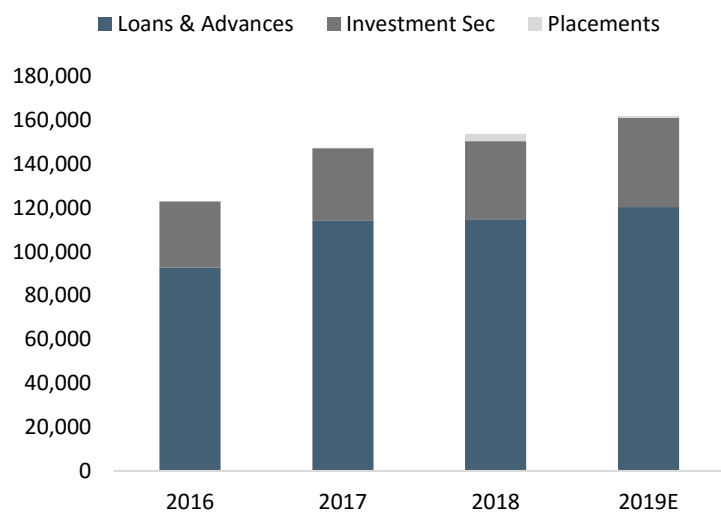
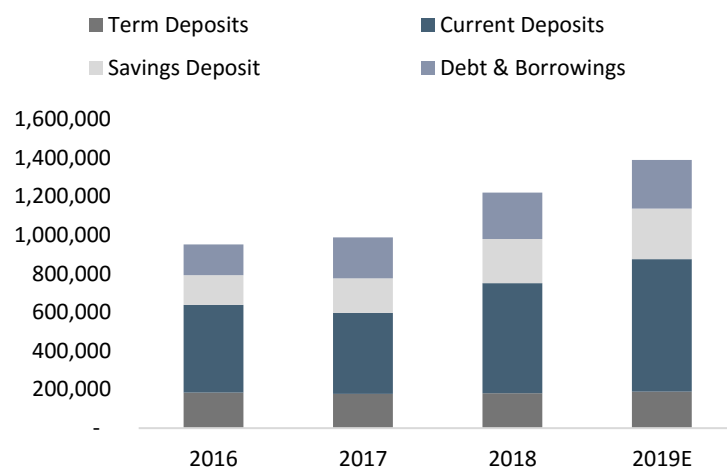


Figure 3: Interest Expense breakdown



Summary of Results and Forecasts

Balance Sheet	2017	2018	2019E	2020E	2021E
Assets					
Inv. Securities	206,238	300,330	337,701	361,747	387,700
Net loans	768737	849880	917052.504	952882.2331	1005480.404
Interest-earning assets	1,027,262	1,261,843	1,344,060	1,406,615	1,487,926
Total assets	1379214	1719883	1814354.134	1892441.417	1989846.951
Liabilities					
Borrowings	325,527	374,607	252,805	265,446	278,718
Deposits	775276	979413	1136880	1223722.944	1299983.607
Interest-bearing liabilities	1,100,803	1,354,020	1,389,685	1,489,169	1,578,702
Total liabilities	1175899	1522124	1602743	1630333.671	1722657.737
Shareholders Equity	203,315	197,759	211,611	262,108	267,189

Income Statement	2017	2018	2019E	2020E	2021E
Gross Earnings	176,570	185,527	190,739	209,888	219,753
Interest Income	147,419	153,682	161,970	176,176	180,481
Interest Expense	(79,278)	(84,095)	(82,021)	(88,877)	(92,917)
Net Interest Income	68,141	69,587	79,949	87,300	87,564
Non-Interest Revenue	29,151	31,845	28,769	33,712	39,272
Gross Earnings	176,570	185,527	190,739	209,888	219,753
Staff Costs	24,535	23,910	21,842	22,391	22,841
Other Costs	42,229	48,218	52,133	55,574	59,249
Total Costs	66,764	72,128	73,974	77,965	82,090
PBT	19,213	25,089	27,985	36,098	37,444
Provision Charge	(11,315)	(4,215)	(6,760)	(6,948)	(7,301)
Tax	(1,445)	(2,163)	(2,519)	(3,610)	(3,744)
Net Profit	17,768	22,926	25,466	32,488	33,700
Dividend Paid	(3,186)	(3,186)	(4,329)	(4,873)	(5,055)

Key YoY growth rates (%)	2017	2018	2019E	2020E	2021E
Loans	7.0%	10.6%	7.9%	3.9%	5.5%
Interest Earning Assets	1.5%	22.8%	6.5%	4.7%	5.8%
Deposits	-2.2%	26.3%	16.1%	7.6%	6.2%
Interest Bearing Liabilities	15.6%	23.0%	2.6%	7.2%	6.0%
Assets	6.2%	24.7%	5.5%	4.3%	5.1%
Gross Earnings	19.2%	5.1%	2.8%	10.0%	4.7%
Costs	-0.7%	8.0%	2.6%	5.4%	5.3%
PBT	73.7%	30.6%	11.5%	29.0%	3.7%
PAT	82.5%	29.0%	11.1%	27.6%	3.7%
EPS	82.5%	29.0%	11.1%	27.6%	3.7%

Per-share data (N)	2017	2018	2019E	2020E	2021E
No of common shares (mn)	28,962,586	28,962,586	28,962,586	28,962,586	28,962,586
EPS	0.61	0.79	0.88	1.12	1.16
DPS	0.11	0.11	0.15	0.17	0.17
BVPS	7.02	6.83	7.31	9.05	9.23

Balance-sheet ratios (%)	2017	2018	2019E	2020E	2021E
Loan/Assets	55.7%	49.4%	50.5%	50.4%	50.5%
Deposit/Liabilities	65.9%	64.3%	70.9%	75.1%	75.5%
Loans/Deposits	99.2%	86.8%	80.7%	77.9%	77.3%
Assets/Equity	6.8	8.7	8.6	7.2	7.4

Asset Quality	2017	2018	2019E	2020E	2021E
NPLs	50,662	51,608	51,181	49,629	46,936
NPLs/Gross Loans (%)	6.4%	5.7%	5.3%	5.0%	4.5%

Margins (%)	2017	2018	2019E	2020E	2021E
Asset Yield	14.5%	13.4%	12.4%	12.8%	12.5%
WACF	7.7%	6.9%	6.0%	6.2%	6.1%
NIM	6.7%	6.1%	6.1%	6.3%	6.1%

Costs (%)	2017	2018	2019E	2020E	2021E
Cost/Income	68.6%	71.1%	68.0%	64.4%	64.7%
Effective tax rate	7.5%	8.6%	9.0%	10.0%	10.0%

Profitability ratios (%)	2017	2018	2019E	2020E	2021E
RoAE	9.1%	11.4%	12.4%	13.7%	12.7%
RoAA	1.3%	1.5%	1.4%	1.8%	1.7%

ARM ratings and recommendations

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6-month period (minimum) to the review date. We adopt a 5-point rating system for this category of stocks and a 3-point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
STRONG BUY	>20%	BUY	>20%
OVERWEIGHT	10% — 20 %	NEUTRAL	5% — 20 %
NEUTRAL	0% — 10 %	SELL	<5%
UNDERWEIGHT	-5% — 0%		
SELL	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject to reasonable portfolio constraints
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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