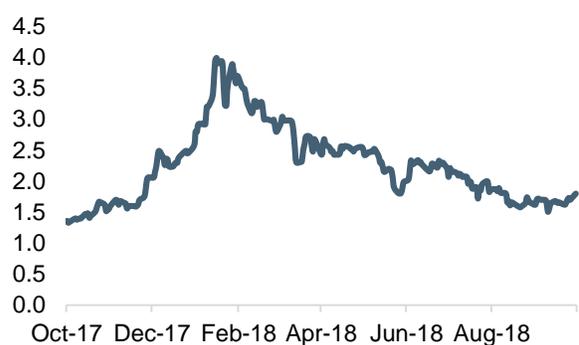




Rating	BUY
Price	₦1.81
FVE	₦2.82
52-week range	₦1.35 – ₦4.33
Market Cap. (₦mn)	52,444
1-month Avg. Vol	9,866,851
Curr. PB	0.28x

FIDELITY.NL - Share Price Trend



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Click link below for recent report on Fidelity

H1 2018 Initial View: [Earnings Breaking Limits](#)

Fidelity Bank Plc. (FIDELITY.NL)

Stock Report

Love at 'second' sight

- Following engagement with management and our updated views on the bank, we have made some adjustment to our expectation on Fidelity with net-impact lowering our FVE to ₦2.82 (previously ₦3.08). Irrespective of the downward review to valuation, we still like Fidelity, and remains our preferred pick in the Tier 2 space (after Stanbic) on the back of its strong fundamentals and thus, retain our **BUY** rating on the stock. Fidelity trades at a FY 18E price-to-book of 0.39x, a premium to Diamond (0.14x) and FCMB (0.18x), which we think is justified based on its first-rate ROAE (10.7%) in FY 18E relative to Diamond (2.1%) and FCMB (6.0%). At current price, our expected dividend of ₦0.15 over FY 18E translates to a dividend yield of ~8%.
- In terms of downward revision, we have adjusted our funding cost expectation over FY 19F – FY 21F mirroring a lower CASA ratio over the period and higher cost on the refinanced Eurobond. On the positives, we now expect loan book to grow by 6% YoY (previously 3%) following a YTD expansion of 3.5% and look forward to a better asset quality over 2018 with NPL ratio revised lower to 6.1% (previously 6.5%). Furthermore, we have lowered our forecast cost of risk by 30bps to 1.0%, which necessitated a moderation in loan loss provision by 28% YoY to ₦8.2 billion (previously ₦10.3 billion) in FY 18.
- On the income line, following the surprise jump in fee and credit income over H1 18, we have adjusted our forecast for Non-Interest-Revenue (NIR) higher to ₦29.5 billion (previously ₦26.4 billion) which more than offset the downward adjustment of our Net Interest Margin to ₦70 billion (previously ₦77 billion).

- Net impact of our adjustment translates to an EPS of ₱0.76 (previously ₱0.72) in FY 2018. At the end of FY 18, we see ROAE touching double-digit (FY 18E: 10.7%, FY 17A: 9.7%) for the first time since FY 12. That said, following upward review to our cost of funds beyond 2018, we lower our earnings forecast over FY 19F and FY 20F by 29% and 19% respectively.

Key take-away from Conference Call

- **Fee Income.** As expected, management attributed the increase in credit related fees over H1 2018 to the expansion in loan book. However, management do not expect this trend to run through the rest of the year.
- **Capital Adequacy Ratio.** The loan related to the single obligor charge in its CAR has a tenor of 4 years. The loan is performing and by FY 2020, it should be below the single obligor limit.
- **Non-Performing Loan.** NPL ratio is expected to moderate below the 5% level by FY 2019.
- **Impairment Write back.** ₱3.3 billion write back in stage 3 loans was from manufacturing sector.

NIR to boost earnings

- Going by the trend in H1 18, we expect fee income to grow by 41% YoY to ₱20.6 billion over 2018 given the sizable gain booked in H1 2018 mainly from credit related fees. Also, given the reclassification of interest income¹, we anticipate some gains amounting to ₱3.1 billion. Lastly, we see limited FX gains (-50% YoY to ₱5.5 billion) over the rest of the year as current convergence between the NAFEX and NIFEX presents a constraint to booking additional FX gain over the rest of the year. On balance, NIR should expand 9% YoY to ₱28.2 billion.

Lower Provisioning on the cards

- We have lowered our forecast for cost of risk by 30bps to 1.0% (FY 2017: 1.5%) and expect coverage ratio (excluding regulatory requirement) to print at 90% (FY 17: 53%) which necessitated a moderation in loan loss provision by 28% YoY to ₱8.2 billion (previously ₱10.3 billion). In terms of asset quality, we expect NPL ratio to moderate to 6.1% (FY 17: 6.4%). Major area of concerns still lie around the Oil & Gas (downstream), Transport, Manufacturing and General Commerce sector which combines accounts for 74.5% of total NPL.

¹ from financial instruments not recognized as fair value through OCI and amortized cost

Contraction in Net Interest Income imminent

- Although, management guided to a higher interest income over H2 2018 due to the upward reversal in yields on fixed income instruments and sustained loan growth, we expect Net Interest Income (NII) to be suppressed due to faster growth in funding cost. According to management, the bank has a longer maturity profile on its investment securities and thus, will not be able to benefit much from the uptick in yields over H2 2018, which necessitated our expectation of lower interest income on investment securities over the period. However, given that the jump in loans to customers over H1 18 (specifically the 8% QoQ growth in Q2 18) did not reflect in interest income over same period, we now look forward to a more noticeable impact over H2 18. On balance, we expect a growth of 6.0% YoY in interest income (₱159.8 billion). On the other hand, higher interest expense on term deposits (+5% YoY to ₱54.8 billion) and higher borrowing cost (+43.8% YoY to ₱24.2 billion) should cause an overall increase in interest expense (+13.2% YoY to ₱89.7 billion). Overall, NII should moderate by 1.9% YoY to ₱70.1 billion.
- Elsewhere, we forecast operating expense to expand 2.4% YoY to ₱67.3 billion with Cost-to-Income (CIR) printing at 67.6% (FY 17: 67.5%). Net impact of our overall adjustment translates to PBT of ₱24.1 billion over FY 18E. Thus, we estimate EPS of ₱0.76 (+17% YoY). We forecast EPS of ₱0.82 and ₱1.00 over FY 19F and FY 20F respectively. In addition, we forecast a dividend pay-out ratio of 20% (FY 17: 17%) which translates to DPS of ₱0.15 and dividend yield of 8% based on current pricing.
- On regulatory base, we believe the bank is on a solid footing as the capital adequacy ratio expanded 200bps to 17% over H1 18. Management guided that the jump resulted from a drop in credit risk assets coming from increased collateral on risk assets and contingents. For the rest of the year, with the consolidation of earnings, we expect CAR to end the year at 17.6%.

Figure 1: Loan Composition (H1 2018)

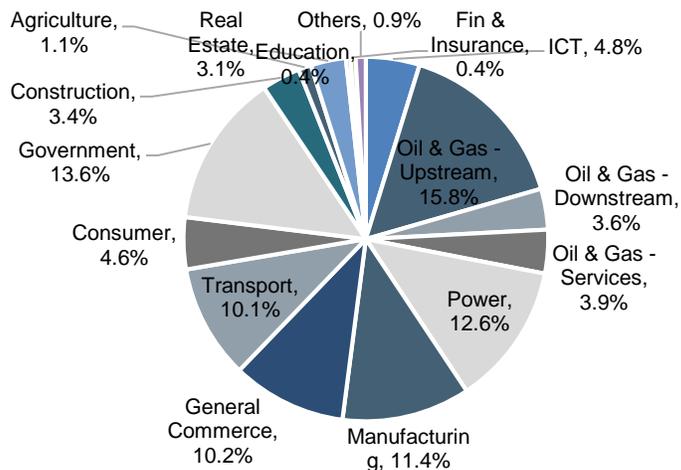
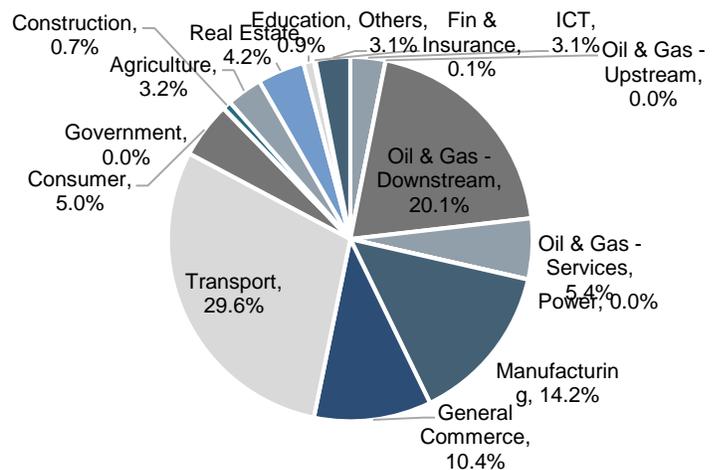


Figure 2: NPL Composition (H1 2018)



Summary of Results and Forecasts

Balance Sheet	2017	2018E	2019E	2020E	2021E
Assets					
Inv. Securities	206,238	298,059	336,325	369,066	405,018
Net loans	768,737	816,531	861,366	922,698	992,886
Gross loans					
Interest-earning assets	1,027,262	1,229,621	1,316,173	1,413,800	1,523,603
Total assets	1,379,214	1,650,177	1,750,769	1,863,751	1,989,930
Liabilities					
Interbank					
Borrowings	325,527	345,437	352,346	359,393	366,581
Deposits	775,276	992,730	1,089,796	1,169,955	1,249,108
Interest-bearing liabilities	1,100,803	1,338,167	1,442,142	1,529,348	1,615,689
Total liabilities	1,175,899	1,442,724	1,544,636	1,632,853	1,720,214
Shareholders' Equity	203,315	207,453	206,132	230,898	269,716
Income Statement					
Interest Income	150,742	159,784	165,842	168,348	169,567
Interest Expense	(79,278)	(89,708)	(92,517)	(89,564)	(87,525)
Net Interest Income	71,464	70,076	73,325	78,784	82,041
Net Fee Income	25,828	29,499	31,149	35,445	40,661
Trading Income					
Other Income					
Gross Earnings	176,570	189,283	196,991	203,793	210,228
Staff Costs	24,535	25,401	26,298	26,959	27,501
Other Costs	40,666	41,862	43,843	45,998	48,300
Total Costs	65,201	67,263	70,140	72,957	75,801
PBT	20,302	24,146	25,720	32,046	38,958
Provision Charge	(11,315)	(8,165)	(8,614)	(9,227)	(7,943)

Tax	(1,445)	(2,173)	(2,058)	(3,205)	(3,896)
Minorities					
Net Profit	18,857	21,973	23,662	28,841	35,062
Dividend Paid	(3,186)	(4,395)	(7,099)	(8,652)	(10,519)

Key YoY growth rates (%)	2017	2018E	2019E	2020E	2021E
Loans	7.0%	6.2%	5.5%	7.1%	7.6%
Interest Earning Assets	1.5%	19.7%	7.0%	7.4%	7.8%
Deposits	-2.2%	28.0%	9.8%	7.4%	6.8%
Interest Bearing Liabilities	15.6%	21.6%	7.8%	6.0%	5.6%
Assets	6.2%	19.6%	6.1%	6.5%	6.8%
Gross Earnings	19.2%	7.2%	4.1%	3.5%	3.2%
Costs	-2.3%	2.4%	4.3%	4.0%	3.9%
PBT	83.5%	18.9%	6.5%	24.6%	21.6%
PAT	93.7%	16.5%	7.7%	21.9%	21.6%
EPS	93.7%	16.5%	7.7%	21.9%	21.6%

Per-share data (N)	2017	2018E	2019E	2020E	2021E
No of common shares (mn)	28,962,586	28,962,586	28,962,586	28,962,586	28,962,586
EPS	0.65	0.76	0.82	1.00	1.21
DPS	0.11	0.15	0.25	0.30	0.36
BVPS	7.02	7.16	7.12	7.97	9.31

Balance-sheet ratios (%)	2017	2018E	2019E	2020E	2021E
Loan/Assets	55.7%	49.5%	49.2%	49.5%	49.9%
Deposit/Liabilities	65.9%	68.8%	70.6%	71.7%	72.6%
Loans/Deposits	99.2%	82.3%	79.0%	78.9%	79.5%
Assets/Equity	6.8	8.0	8.5	8.1	7.4

Asset Quality	2017	2018E	2019E	2020E	2021E
NPLs	50,662	52,532	47,542	47,932	46,133
NPLs/Gross Loans (%)	6.4%	6.1%	5.3%	5.0%	4.5%

Margins (%)	2017	2018E	2019E	2020E	2021E
Asset Yield	14.8%	14.2%	13.0%	12.3%	11.5%
WACF	7.7%	7.4%	6.7%	6.0%	5.6%
NIM	7.0%	6.2%	5.8%	5.8%	5.6%

Costs (%)	2017	2018E	2019E	2020E	2021E
Cost/Income	67.5%	67.6%	67.1%	63.9%	61.8%
Effective tax rate	7.1%	9.0%	8.0%	10.0%	10.0%

Profitability ratios (%)	2017	2018E	2019E	2020E	2021E
RoAE	9.7%	10.7%	11.4%	13.2%	14.0%
RoAA	1.4%	1.5%	1.4%	1.6%	1.8%

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
RESTRICTED	In certain circumstances, Asset & Resource Management ("ARM") Group policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of ARM Securities' and/or ARM Group's engagement in an investment banking transaction and in certain other circumstances.

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