



Rating	<b>STRONG BUY</b>
Price	₦12.65
FVE	<b>₦16.69</b>
52-week range	₦2.90- <del>₦14.75</del>
Market Cap. (₦'bn)	414.59
1-month Avg. Vol	14,658,380
Curr. PE	18.8x

Quarterly EPS	Q1	Q2	Q3	Q4
<b>2016 A</b>	0.58	0.42	0.19	<b>0.71</b>
<b>2017 A(E*)</b>	0.45	0.37	0.46	0.44*

#### FBNH:NL - Share Price Trend



#### Analyst(s)

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## First Bank of Nigeria Holdings Plc. (FBNH: NL)

### Company Note

### Regaining its Mojo; Upgrade to **STRONG BUY**

- Across our Tier 1 banking universe, we beam our spotlight on FBN Holdings (FBNH). The bank trades at a P/B of 0.7x compared to peer average of 1.4x, and its FY 17E P/E of 6.6x is at a sizable discount to current P/E of 18.8x. Furthermore, at current pricing, our 2017E dividend translates to dividend yield of 6.8%.
- Our View:** Following a dramatic share price decline (-21.7% from the year-peak of ₦14.75), FBNH looks increasingly attractive underpinned by improving asset quality and above par core banking metrics. Precisely, we see further potential upside from lower provisioning, resilience in Net Interest Margin (NIM), operational efficiency and possible streamlining of branches. Consequently, we estimate FY 17E EPS of ₦1.72 (9M 17: ₦1.28) and ₦3.18 for FY 18F – implying a 260% and 85% growth in EPS in FY 17E and FY 18F accordingly, given the materially low base in 2016.

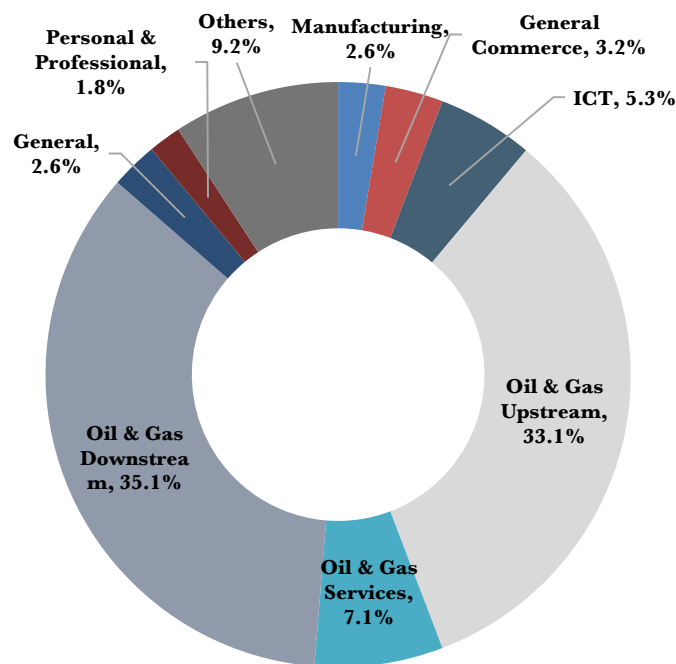
**Table 1: Summary of Result and Forecast**

Income Statement (₦'million)	FY 15A	FY 16A	FY 17E	FY 18F
<b>Gross Earnings</b>	491,535	570,765	580,260	592,223
<b>Net Interest Income</b>	265,165	304,442	345,480	351,760
<b>Loan loss provision</b>	118,794	226,037	136,133	78,457
<b>PBT</b>	21,541	22,948	71,789	135,722
Key Ratios	FY 15A	FY 16A	FY 17E	FY 18F
<b>EPS</b>	0.43	0.48	1.72	3.18
<b>DPS</b>	0.15	0.22	0.77	1.43
<b>NIM</b>	8.4%	9.8%	10.7%	10.7%
<b>NPL</b>	18.1%	24.9%	20.0%	18.0%
<b>Cost of Risk</b>	6.5%	10.8%	6.5%	3.5%
<b>Cost - Income Ratio</b>	61.6%	47.0%	52.3%	52.1%
<b>Liquidity Ratio</b>	36.2%	33.6%	30.7%	30.5%
<b>Capital Adequacy Ratio</b>	16.7%	17.8%	21.6%	22.0%

### Lower provisioning guides to earnings expansion

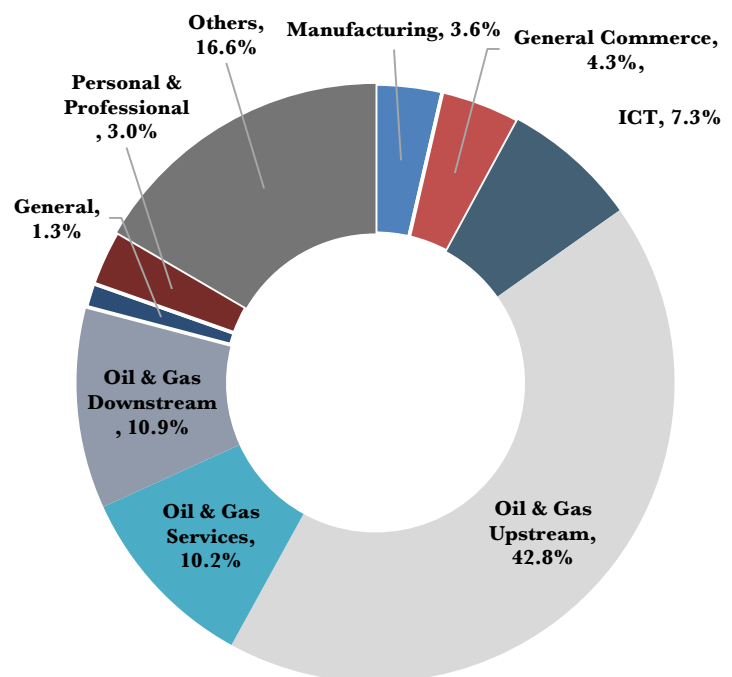
- Over the last 11 quarters, FBNH has booked ~~~N~~442 billion on loan loss provision stemming from deteriorating loan quality with NPL ratio and Cost of Risk (CoR) printing at 25% and 10.8% respectively as at FY 2016 (FY 2015: 18.1% and 6.1%). Much of the provisioning stemmed from concerns on its exposures to Oil & Gas, ICT and Manufacturing sectors with Atlantic Energy, 9mobile, Oando, amongst others posing specific risk to loan quality. Irrespective, over the first nine-months of 2017, asset quality has recovered with NPL and cost of risk declining to 20% and 6.4% respectively. Much of the improvement has come from the downstream oil and gas sector where NPL concentration declined to 11% in 9M 17 from 35% in FY 16. According to management, the bank has achieved noteworthy progress with regards to the remediation of its two largest delinquent assets in the subsector. Management also noted that it has restructured the credit facility and received cash flow required to make interest payments over 2017. Consequently, the bank reclassified the assets as performing in the third quarter.

**Figure 1: NPL Composition by Sector (FY 2016)**



Source: Company Financials, ARM Research

**Figure 2: NPL Composition by Sector (9M 2017)**

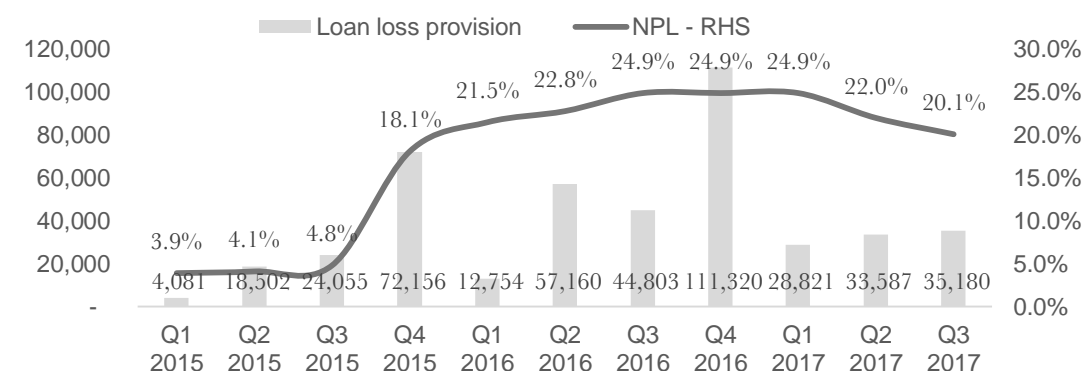


- Going forward, we expect to see sizable improvement from its upstream Oil and Gas (O&G) exposure which currently constitutes 43% of NPL as at 9M 17. Given the recovery in crude oil production and higher crude oil prices, we expect upstream O&G NPL to moderate to ~30% in FY 18. Thus, Atlantic Energy loan, of ~~~N~~140 billion, is expected to remain the

major NPL in its upstream O&G books. On that front, though management is optimistic on a possible resolution even as assets (8 oil fields) remains productive, government delays has informed our cautious view on NPLs reclassification. Furthermore, we expect the collateral of dragging downstream assets to be disposed, which supports further contraction in downstream NPLs.

- Elsewhere on 9mobile and Oando, the resolution of 9mobile's debt is progressing well. The infrastructure of the business is quite modern being the last of the licensed Telcos with significant interest from a number of investors. In addition, the business has not significantly lost customers and its revenue remains very strong. We expect conclusion of sale by YE 2018. Oando is essentially an ownership dispute. The operational activities of the business have not been curtailed by any means. Similarly, we do not expect any significant impact on Oando's capacity to meet its obligations. Notwithstanding, FBNH's exposure to 9mobile and Oando is relatively low at 1.25% and 0.05% of the bank's loan book respectively.
- **More of reclassification than write-backs:** While the prospect of reclassifying NPLs to performing loans guides to a possibility for write-backs, we note concerns on exposure to manufacturing, trade, and real estate. Though regulatory guidelines remain pending, the adoption of IFRS 9 signifies a shift from incurred to expected losses. Thus, we think the long-term outlook on crude oil price, which ties to the fragility of these sectors, guides to the prospect of reclassification of impairments. Consequently, we tilt towards the side of prudence and expect sector reclassification on collective provisioning which cools off the possibility of complete write-backs. Overall, we forecast NPL and Cost of Risk in FY 18F to print at 18% (FY 17E: 20%) and 3.5% (FY 17E: 6.5%) respectively. This implies FY 2018 loan loss provisioning of ₦78.5 billion relative to ₦138.1 billion for FY 17E.

**Figure 3: NPL Ratio (%) and Loan loss provision (₦million) trend**



Source: Company Financials, ARM Research

- Asset quality risk and earnings:** We present a sensitivity analysis of Cost of Risk and provisioning (impairment) to earnings. Our analysis shows a 300bps increase in Cost of Risk to 6.5% (same as 2017) which according to our estimates imply a 7% decline in EPS for FY 2018E. We highlight that our stress test analysis here is based on a worst-case scenario where the bank may have to provide more for specific assets with concerns. The possibility of this scenario playing out is small, in our view. Consequently, we maintain our base case assumption of 3.5% Cost of Risk, which guides to provisioning of ₹78 billion and PAT of ₹114 billion for FY 2018F.

**Table 2: Sensitivity Analysis of Cost of Risk to Earnings**

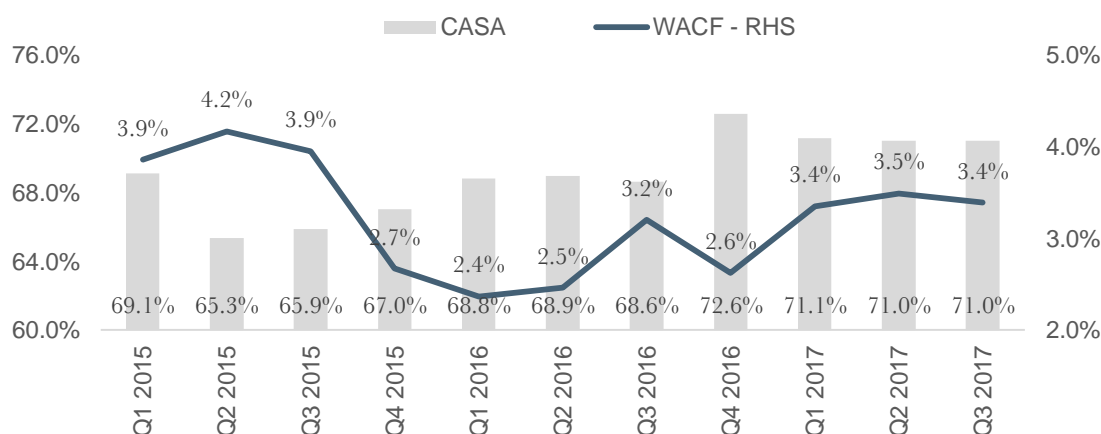
Cost of risk	1.5%	2.0%	3.0%	3.5%	4.0%	4.5%	5.5%	6.0%	6.5%	7.0%
Impairment	33,625	44,833	67,249	78,457	89,666	100,874	123,290	134,498	145,707	156,915
EBIT-OPEX	214,179	214,179	214,179	214,179	214,179	214,179	214,179	214,179	214,179	214,179
PBT	180,555	169,346	146,930	135,722	124,514	113,305	90,889	79,681	68,473	57,264
Tax rate	28,889	27,095	23,509	21,715	19,922	18,129	14,542	12,749	10,956	9,162
PAT	151,666	142,251	123,421	114,006	104,591	95,177	76,347	66,932	57,517	48,102

Source: ARM Research

### Operational efficiency to remain resilience

- Excluding asset quality concerns, FBNH core banking metrics remain above peer average with key metrics pointing to sustained momentum. Central to core performance is the robust contribution of higher asset yields to interest income and lower funding cost to expansion in NIMs. On funding cost, FBNH's deposit mix (CASA/total deposits 9M 17: +2.4pps YoY to 71%) guides to benign pressure on this front with FY 17 WACF projected at 3.6% (FY 2016: 2.8%). Going forward, we expect funding cost to remain flat in 2018 (3.7%) and average 3.8% between 2019F-2021F.

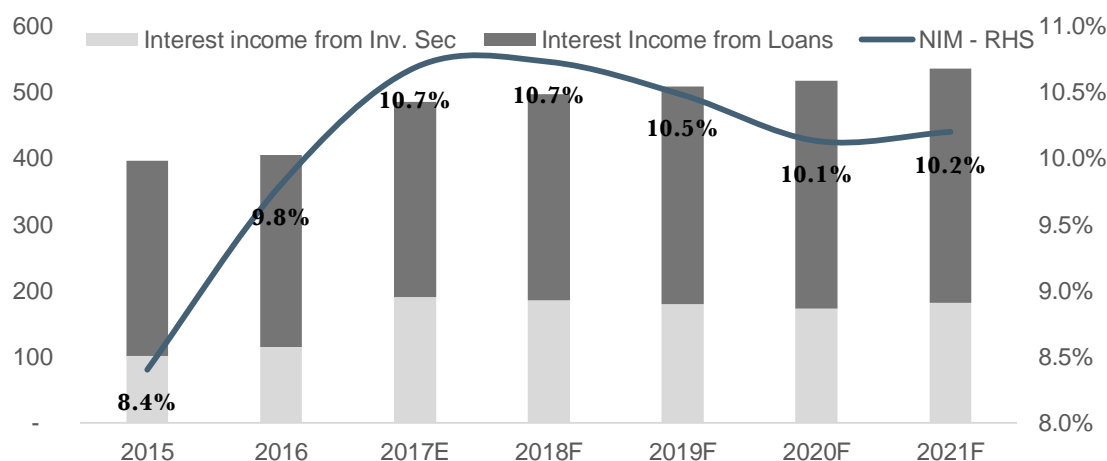
**Figure 4: Deposit Mix and Funding Cost (WACF) Trend**



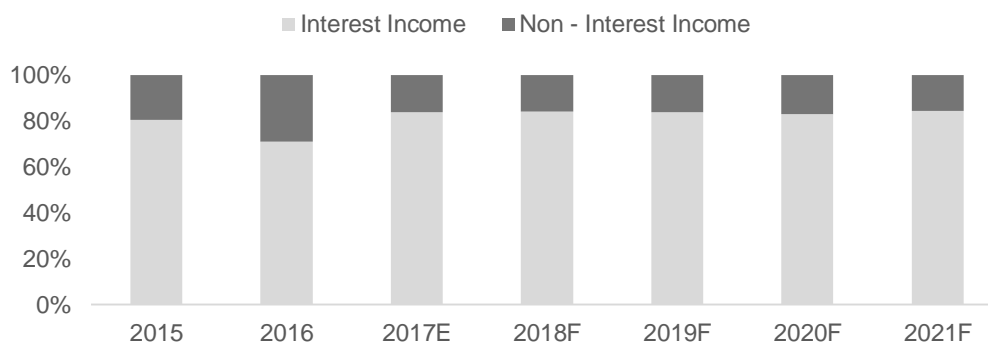
Source: Company Financials, ARM Research

- On asset yields, despite our expectation of a 200bps decline in yields on investment securities, the largely sticky nature of interest rate on loan books should moderate the impact of a lower yield environment. Accordingly, we forecast asset yields of 15% for 2017E and 2018F, and an average of 14.8% for the period 2019F-2021F. Overall, we forecast NIMs of 10.7% for 2017E and 2018F.
- According to Management, the aim is to protect NIMs, leveraging on its low-cost funding structure even as it remains focused on optimizing income from interest earning assets while further driving increased non-interest income contribution. On the latter, Management noted that the bank has ~13 million active customer accounts with at least 80% of the customer induced transactions done on its digital platform. The bank has at least 35% of all electronic traffic in Nigeria either by count or value on the Interswitch platform and remains the only bank to process over 100million transactions per month on the Interswitch platform multiple times. The bank is currently setting up a digital lab to further drive innovative solutions.

**Figure 5: Interest Income composition and NIMs**



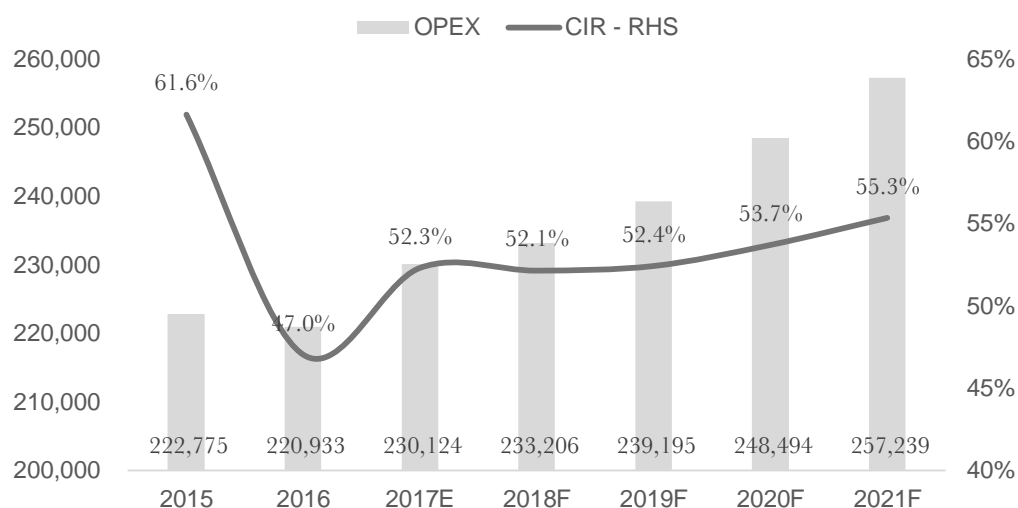
**Figure 6: Gross Earnings composition**



Source: Company Financials, ARM Research

- Further down, operational efficiency has been upbeat with Cost to Income ratio (CIR) in 9M 2017 of 53.4% lower than its 5-year average (*excluding 2016 where FX-induced income drove CIR lower to 47%*). We now estimate FY 17E OPEX of ₦230 billion (9M 17: ₦175 billion). Further out, we forecast a 3% average growth in OPEX over 2018F – 2021F. The foregoing, alongside our gross earnings forecast guides to relatively flattish CIR over our forecast period. To note, management guides to a possible review of some branches as the bank is currently piloting the agency banking model.

**Figure 7: Operating Expense (₦'million) and Cost to Income ratio trend**



Source: Company Financials, ARM Research

### ***Sustained recovery to drive earnings growth in FY 2018F***

- In summary, with a focus on leveraging lower funding cost, operational efficiency, adequate capital buffer, no plans to grow risky assets, and lower loan-loss provisioning, downside risk to 2018 earnings now seems moderated than was earlier expected. Overall, we forecast 2018F EPS of ₦3.18 (+85% YoY) and DPS of ₦1.43. FBNH trades at a P/B of 0.7x compared to peer average of 1.4x with FY 17 P/B of 0.4x at a discount to peer average of 0.9x. Furthermore, at current pricing, its 2017E dividend translates to dividend yield of 6.4%. Our FVE of **₦16.69** translates to a 32% upside from current pricing. Consequently, we rate the stock a **STRONG BUY**, reflecting attractive valuation and a view that fundamentals will improve going forward.

## Summary of Results and Forecasts - Naira (₦)

ANNUAL						
Income Statement (₦'m) *	2015A	2016A	2017E	2018F	2019F	2020F
Interest Income	395,162	405,281	485,696	496,598	508,540	517,734
Interest Expense	(129,997)	(100,839)	(140,215)	(144,838)	(151,831)	(160,870)
Net interest income	265,165	304,442	345,480	351,760	356,710	356,864
Non-Interest Revenue	96,373	165,484	94,565	95,625	99,686	105,957
OPEX	(222,775)	(220,933)	(230,124)	(233,206)	(239,195)	(248,494)
Provisions	(118,794)	(226,037)	(138,133)	(78,457)	(71,096)	(52,030)
PBT	21,541	22,948	71,789	135,722	146,104	162,298
PAT	15,499	17,141	61,738	114,006	122,727	136,330
Balance Sheet (₦ '000)						
*						
Total Assets	4,166,189	4,736,805	4,787,425	5,020,514	5,194,027	5,417,176
Liabilities						
Deposits	2,970,922	3,104,221	2,980,052	3,129,055	3,222,926	3,351,843
Total liabilities	3,587,389	4,154,230	4,166,026	4,335,973	4,447,693	4,602,200
Shareholders' fund	578,800	582,575	621,399	684,541	746,334	814,976
Key Ratios	2015A	2016A	2017E	2018F	2019F	2020F
EPS	0.43	0.48	1.72	3.18	3.42	3.80
DPS	0.15	0.22	0.77	1.43	1.71	1.90
BVPS	16.12	16.23	17.31	19.07	20.79	22.70
P/B	11.88	7.02	3.04	1.65	1.53	1.38
ROE	2.81%	2.95%	10.26%	17.46%	17.15%	17.46%
Loans/Deposit	61%	67%	71%	72%	74%	78%
Cost to income	62%	47%	52%	52%	52%	54%
Liquidity ratio	36%	34%	31%	30%	29%	25%
WACF	3.7%	2.8%	3.6%	3.7%	3.7%	3.8%
Asset yields	12.5%	13.1%	15.0%	15.1%	14.9%	14.7%
Cost of risk	6.5%	10.8%	6.5%	3.5%	3.0%	2.0%
NPL	18.1%	24.9%	20.0%	18.0%	15.0%	10.0%

Source: ARM Research \*unless otherwise stated

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