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Equity Research

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Rating	STRONG BUY
Price	₦7.25
FVE	₦9.12
52-week range	₦6.75 – ₦12.15
Market Cap. (₦Mn)	260,241
1-month Avg. Vol	13,730,504.65
Curr. PB	0.49x

FBNH.NL - Share Price Trend



Analyst(s)

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FBN Holdings Plc. (FBNH.NL)

Stock Report

Value Play or Value Trap?

- Following the Analyst call few weeks ago and our follow up engagement with management, we have updated our model with adjustment for expected write-off in NPLs. While we do not rule out the possibility of management achieving the single digit NPL by FY 19, we are however concerned by the quality of loans in the Stage 2 bucket, with 51% of corporate loans (₦272.6 billion) in that bucket already 90 days past due. As such, we expect credit loss provision to remain elevated and forecast cost of risk of 5% in FY 19 and FY 20. Relaying from the above and the still elevated NPL (25.3% in Q1 19), we see limited room for any net-loan growth during the year and estimate 5% YoY decline in net loan book to ₦1.6 trillion (management guidance of 5% growth YoY)
- While we expect non-interest revenue to remain resilient, our estimate of elevated loan loss provision resulted in decline in FY 19E EPS by 6.2% YoY to ₦1.56. Beyond 2019, we model gradual improvement in net loan book, expansion in CASA proportion of deposits and still resilient fee income. As such, we expect FY 20F and FY 21F EPS growth of forecasts of 10.1% and 24.7% respectively. Although, the adjustment to our model translated to FVE of ₦9.12, which translates to a **STRONG BUY** recommendation on our rating scale, key risks to our expectation is a more aggressive write-off during the year which could result in a much higher provisioning than expected. As such, we see the play in FBNH as a beyond 2019 game. FBNH trades at FY 19F price-to-book of 0.5x, a discount to Tier 1 average of 1.0x.

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- ***Estimating the extent of write-off.*** After three years of reclassification, restructuring and gradual provisioning, the hard stance on Atlantic Energy over Q4 18 has set the stage for a definitive material clean-up of the loan book, with management guiding to a 10% non-performing loan ratio by FY 19 (Q1 19: 25.3%). Notably, while the current NPL stood ₦535.5 billion, absolute coverage for Stage 3 loans settled at ₦385.7 billion translating to a coverage ratio of 72%. Although management guided to increasing the coverage level to ~90% to allow it enough latitude to achieve 100% coverage on some loans, a condition for a complete write-off, we chose a more conservative approach and assume complete write-off of 85% of current Stage 3 coverage of ₦328 billion. Consequently, we expect the NPL book to decline to ₦207 billion and gross loans by 12.7% YoY to ₦1.8 trillion.
 - Also, we expect management to improve coverage on the outstanding NPL which guides to 5% cost of risk during the year (total provisioning of ₦79.9 billion), which is 100bps above management upper band guidance. As a result, we estimate 66% coverage on the outstanding NPL by FY 19 and a gradual increase in coverage over our forecast period to 100% by FY 2021. As at Q1 2019, capital adequacy ratio (CAR) printed at 16.5%, from 17.3% in FY 18. With the group's retained earnings at an historic low, we had expected a capital raise to beef up regulatory capital. However, management guided to increasing its retention rate and expects 2% accretion to CAR every six months from profitability (₦6 billion). With our model suggesting increase in retained earnings by FY 19 to ₦52 billion and decline in net loan growth in the course of the year, we see CAR printing at 17.5% by FY 19.
 - ***Asset quality worries to constrain credit creation.*** At its full year 2018/Q1 19 analysts conference call, management guided to ~5% (-15.9% YoY in FY 18) growth in net loans over 2019, with focus on manufacturing sector, consumer, retail, agriculture and agro-allied. While we see the guidance as quite conservative relative to GTB, ZENITH and UBA management guidance of 10%, 7.5% and 12% respectively, we believe the asset quality worries, in the face of sizeable write-offs will constrain room for any loan growth during the year. Particularly, we forecast 5% YoY decline in net loan book to ₦1.6 trillion. On NPL, beyond the full provision for Atlantic Energy, management stated that its exposure to Ontario was resolved through asset realization and a haircut. Also, they guided that Aiteo is not classified as NPL because the asset is still performing.
 - ***Moderating loan yields and aggressive play in treasury assets to suppress NIM.*** Reflecting our expectation of moderation in net loan book, amidst downward repricing of loans, we believe volume in treasury assets will be the catalyst for growth in interest income.

Consequently, we expect expansion in treasury instruments and loans to banks by 17.4% YoY to ₱3.5 trillion. Accordingly, we estimate 23% YoY expansion in interest income on investment securities to ₱193 billion. However, we believe the impact will be offset by decline in interest on loans to customers by 15% YoY to ₱223.9 billion. As a result, we see moderate expansion in interest income by 1.2% YoY to ₱439 billion, with related yield on assets declining 50bps YoY. On funding cost, FBNH's improving deposit mix (CASA/total deposits Q1 19: +967bps YoY to 78%) guides to benign pressure on this front with FY 17 WACF projected at 3.2% (FY 2018: 3.4%). Reflecting the faster decline in assets yield, we expect contraction in NIM by 40bps YoY.

- ***Growth in core fee income to support NIR.*** We estimate non-interest revenue (NIR) to remain strong over 2019 reflecting resilience in fee income (+8% YoY), which offsets declines on FX gains (-18% YoY) and loss on instruments classified as FVTPL. Much of the gain in fee income will be coming from the e-banking business, credit related fees, funds transfer, and account maintenance fees. Furthermore, we expect a 7% YoY growth in net-insurance income, 9% YoY growth in dividend income and 18% YoY growth in other operating income. Consequently, non-interest revenue (NIR) should expand by just 4.4% YoY to ₱137.5 billion over FY 19E.
- ***Compelling near-term story, not a short-term play.*** Net impact of our overall adjustment translates to PBT of ₱63.7 billion (-2.4% YoY) and EPS of ₱1.56 (-6.2% YoY) over 2019. We forecast EPS of ₱1.72 (+10.1% YoY) and ₱2.14 (+24.7% YoY) over FY 20F and FY 21F respectively. FBNH trades at a FY 19E P/B of 0.5x, at a discount to Tier 1 average of 1.0x. At current price, our expected dividend of ₱0.25 (coming largely from the group not the bank) over FY 19F translates to a dividend yield of 3.1%.

Summary of Results and Forecasts

Balance Sheet	2017	2018A	2019E	2020E	2021E
Assets					
Inv. Securities	1,541,246	2,082,034	2,394,339	2,753,490	3,028,839
Net loans	2,001,223	1,683,813	1,599,622	1,550,005	1,596,505
Interest-earning assets	4,285,398	4,629,282	4,952,374	5,376,917	5,806,109
Total assets	5,236,537	5,568,316	5,925,448	6,406,264	6,912,391
Liabilities					
Borrowings	423,122	340,154	370,768	411,552	448,592
Deposits	3,143,338	3,486,691	3,765,626	4,142,189	4,514,986
Interest-bearing liabilities	4,231,826	4,576,160	4,930,668	5,435,385	5,924,570
Total liabilities	4,558,345	5,037,669	5,392,177	5,896,894	6,386,079
Shareholders Equity	678,192	530,647	533,271	509,370	526,312

Income Statement	2017	2018A	2019E	2020E	2021E
Gross Earnings	582,899	566,124	576,938	590,565	623,339
Interest Income	469,586	434,410	439,458	464,236	495,686
Interest Expense	(138,064)	(150,242)	(153,219)	(169,182)	(184,408)
Net Interest Income	331,522	284,168	286,238	295,054	311,278
Net Fee Income	62,336	75,394	81,426	77,354	80,448
Other Income	50,977	56,320	56,054	48,975	47,204
Staff Costs	85,678	93,395	99,073	104,067	110,363
Other Costs	150,600	165,594	180,973	168,084	173,130
Total Costs	236,278	258,989	280,047	272,150	283,492
Provision Charge	(150,424)	(86,911)	(79,981)	(77,500)	(63,860)
PBT	54,522	65,288	63,691	71,733	91,579
Tax	(9,040)	(5,544)	(7,643)	(10,043)	(14,653)
Net Profit	45,482	59,744	56,048	61,690	76,926

Key YoY growth rates (%)	2017	2018A	2019E	2020E	2021E
Loans	-4.0%	-15.9%	-5.0%	-3.1%	3.0%
Interest Earning Assets	6.3%	-4.6%	-2.0%	3.7%	6.8%
Deposits	1.3%	10.9%	8.0%	10.0%	9.0%
Interest Bearing Liabilities	10.2%	8.1%	7.7%	10.2%	9.0%
Assets	19.5%	6.7%	18.3%	18.0%	1.6%
Gross Earnings	2.1%	-2.9%	1.9%	2.4%	5.5%
Costs	8.8%	9.7%	6.2%	-2.8%	4.2%
PBT	137.6%	19.7%	-2.4%	12.6%	27.7%
PAT	165.3%	31.4%	-6.2%	10.1%	24.7%
EPS	165.3%	31.4%	-6.2%	10.1%	24.7%

Per-share data (N)	2017	2018A	2019E	2020E	2021E
No of common shares (mn)	35,895	35,895	35,895	35,895	35,895
EPS	1.27	1.66	1.56	1.72	2.14
DPS	0.25	0.26	0.25	0.27	0.34
BVPS	18.89	14.78	14.86	14.19	14.66

Balance-sheet ratios (%)	2017	2018A	2019E	2020E	2021E
Loan/Assets	38.2%	30.2%	27.0%	24.2%	23.1%
Deposit/Liabilities	69.0%	69.2%	69.8%	70.2%	70.7%
Loans/Deposits	63.7%	48.3%	42.5%	37.4%	62.7%
Assets/Equity	7.72	10.49	11.11	12.58	13.13
Asset Quality (%)	2017	2018A	2019E	2020E	2021E
NPLs/Gross Loans	22.8%	23.4%	10.0%	10.0%	8.0%
Credit Charge	7.5%	5.2%	5.0%	5.0%	4.0%
Total CAR	17.7%	17.3%	17.0%	17.3%	18.2%
Margins (%)	2017	2018A	2019E	2020E	2021E
Asset Yield	11.6%	9.7%	9.2%	9.0%	8.9%
WACF	3.4%	3.4%	3.2%	3.3%	3.2%
NIM	8.2%	6.4%	6.0%	5.7%	5.6%
Costs (%)	2017	2018A	2019E	2020E	2021E
Cost/Income	54.0%	63.4%	66.1%	64.6%	64.6%
Effective tax rate	16.6%	8.5%	12.0%	14.0%	16.0%
Profitability ratios (%)	2017	2018A	2019E	2020E	2021E
RoAE	7.2%	9.9%	10.5%	11.8%	14.9%
RoAA	0.9%	1.1%	1.0%	1.0%	1.2%

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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