

**FBN Holdings Plc. | Earnings Report**
**Basking in the realm of high NIMs**
**(SELL: ₦5.23)**

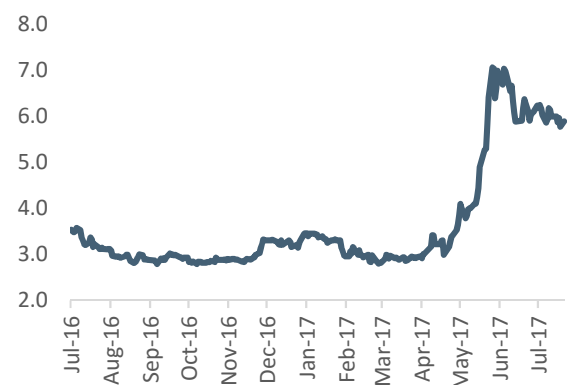
- FBN Holdings (FBNH) reported strong core earnings in Q2 17, with key metrics pointing to sustained momentum for the rest of the year. Central to core performance was the robust contribution of higher asset yields to interest income which offset pressures on funding cost to drive expansion in net interest margins (NIMs). Irrespective, bottom-line was weaker compared to prior quarter and corresponding period of 2016 as material decline in foreign exchange gains combined with impairment charges and operating expenses (OPEX) to drive EPS to ₦0.37 (Q1 17: ₦0.45, Q2 16: ₦0.42). Excluding the foreign exchange gains in Q2 16 (₦52.9billion) and Q2 17 (₦2.2billion), and adjusting impairment charges in Q2 17 for similar cost of risk as with Q2 16 (8.1%), EPS should print at ₦0.04 (Q2 16: loss after tax of ₦1.05).

- Going forward, we assume a 6% decline in loans as well as higher FY 17E PBT of ₦50.3billion (2016: ₦22.9billion) amidst tamer prospects for NGN depreciation relative to 2016. The upbeat earnings reflect expectations that FBNH would continue to capture higher yields on the naira curve as well as enjoy possible write-backs. However, we model cost of risk at 7.5% (H1 17: 6.2%) and cost-income ratio at 55.6% (H1 17: 54.4%) to factor higher impairment charges in H2 17 and further slack in cost efficiency. Relative to our FY 17 forecast of ₦1.21, annualized EPS of ₦1.64 is 36% ahead, reflecting

Income Statement Data			
	2017 – 6M'm	2016 – 6M'm	%chg
<b>Gross Earnings</b>	<b>282,715</b>	<b>263,263</b>	7.4%
PBT	35,628	45,889	-22.4%
<b>PAT</b>	<b>29,486</b>	<b>35,858</b>	-17.8%
EPS	0.82	1.00	-17.8%

Balance Sheet Data			
	2017- 6M 'm	2016 -Dec 'm	%chg
<b>Loans</b>	1,998,544	2,083,894	-4%
<b>Total Assets</b>	4,830,283	4,736,805	2%
<b>Deposits</b>	2,996,707	3,104,221	-3%
<b>Total liabilities</b>	4,271,146	4,154,230	3%
<b>Net Assets</b>	559,137	582,575	-4%
<b>BVPS</b>	15.58	16.23	-4%

Stock Data	
<b>Price</b>	₦5.96
<b>52-week range</b>	₦2.95 – ₦7.79
<b>Market Cap. (N'm)</b>	207,475
<b>1-month Avg. Vol</b>	1,611,300
<b>Curr. PE</b>	16x
<b>Bloomberg Ticker</b>	FBNH:NL
<b>FBN Holdings Plc- Share Price Trend</b>	

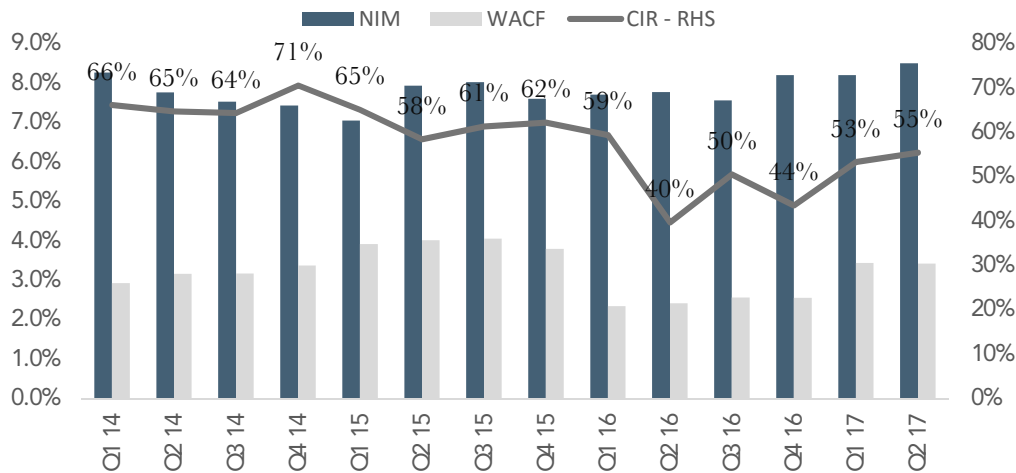

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our views on cost. Our FVE estimate of **₱5.23** guides to a **SELL** rating on the stock.

*Elevated interest rate environment swings NIM higher*

- Similar to sector trend over the review period, elevated interest rate environment provided a support for gross earnings (+4% QoQ) as FBNH booked ₱118.3billion in interest income vs our ₱113billion forecast due to stronger asset yields (+250bps QoQ) on the back of higher yields on investment securities while the bank also increased the yield on its loan book. Outperformance relative to our forecast reflects our bearish views about possibility of upward loan repricing in the period. Net loan declined (3% QoQ) in line with the bank’s cautiousness on the origination of new loans even as it worked towards a clear-out of loan books. Further down, funding cost, which was largely tamed (interest expense: +2% QoQ), supported a 30bps expansion in NIMs to 8.5%. Deposit breakdown reveals lower expensive deposit (term funding: -3.8pps QoQ) even as CASA remains at 71% of deposit mix.

**Figure 1: Trend in NIM, WACF and CIR**



Source: Company financials, ARM Research

*Gains on derivatives position bolster NIR in Q2 17...*

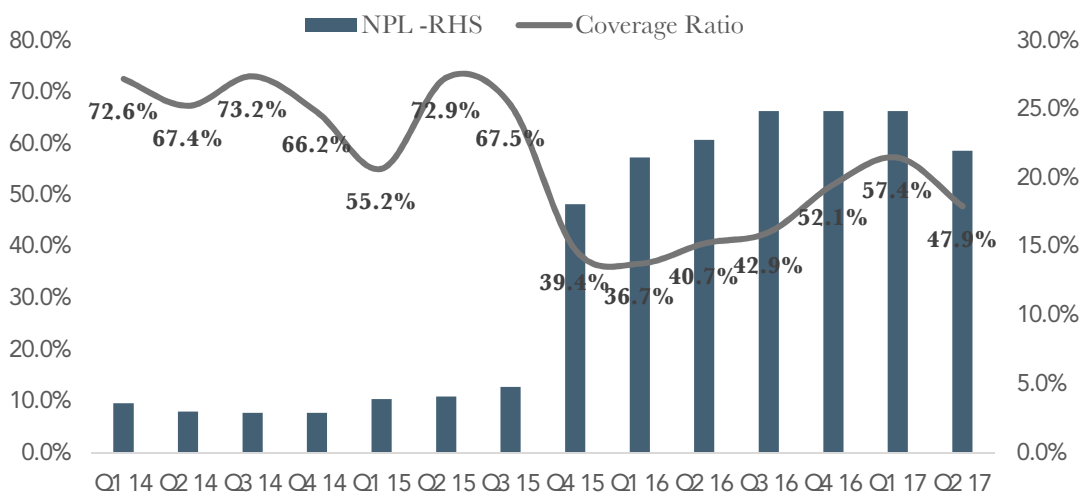
- Parsing through NIR sub-part reveals ₱4.4billion gains on HFT derivative instruments (Q1 17: ₱1.2billion), which in our view, reflects translation of currency

swap and forward positions (Est: \$51million) at the new NAFEX rate after the introduction of the Investors and Exporters Window (IEW) in April 2017. Consequently, supported by an underwriting profit of ₦3.8billion (~double-fold QoQ) as well as marginal increase (+2% QoQ) in net fee income to ₦15.6billion, NIR grew 8.3% from prior quarter to ₦26.2billion

*...though softer cost control drives rebound in CIR*

- Offsetting NIR gains, OPEX climbed 9.3% QoQ to ₦60.9billion due to pressure from other OPEX (+17.3% QoQ) which knocked off marginal decline in personal expenses (-0.7% QoQ). Consequently, cost-income ratio further deteriorated to 55.4% (six quarter average: 50%).
- Largely reflecting a write-off of previously provisioned (₦108billion), NPL declined 18% QoQ (-7.4% YoY) with corresponding ratio down 2.9pps QoQ to 22%. However, impairment charges climbed 16.5% relative to prior quarter reflecting higher specific provision that continues to reverberate asset quality concerns for the bank - annualized cost of risk of 4.9% is 60bps higher QoQ. Consequently, coverage ratio reclined to 48% (Q1 17: 57%) - a lean cover for NPL book.

**Figure 2: Trend in NPL and coverage ratios**



Source: Company financials, ARM Research

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### *Still on track for a decent FY 2017E*

- For the rest of the year, we see retention of a hawkish monetary policy stance as supportive of high yielding environment, which leaves scope for momentum in interest income. While loan growth should remain muted, our views on interest rates inform our forecasts for FY 17E interest income (+17% YoY to ₱475billion and interest expense (₱146billion). For NIR, while sustained derivative gains and other income leaves scope for NIR growth over H2 17, the relatively stable outlook for FX tempers overall NIR reading (FY 17E: -43% YoY to ₱94.2billion).
  - On impairment charges, though we expect the improved macro picture, specifically higher crude oil production and prices as well as improved dollar liquidity, to moderate impairment readings, we are of the view that the banks' move to clean up its books as well as lean NPL cover leave scope for sticky impairment readings. Consequently, we forecast FY 17E impairment charges at ₱147billion. Implied in our forecast is annualized cost of risk of 7.5% vs. management guidance of 7%.
  - Cumulative impact of the adjustments results in FY 17E EPS of ₱1.21 (+152% YoY) which largely reflects the strength of our net interest income projection and our views regarding flattish impairment charges. FBNH currently trades at a 2017 P/E of 4.8x and P/B of 0.3x vs. peers of 5.4x and 0.9x – ROAE of 7.2% (2016: 3.1%). In line with the wider banking sector, FBNH has rallied 78% YTD (Banking sector: +73%YTD) and in view of the high NPL ratio, we believe the stock is now richly valued and maintain a **SELL** rating with FVE of **₱5.23**.
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## Summary of Results and Forecasts - Naira (₦)

<b>ANNUAL</b>					
Income Statement (N'000) *	FY 2015A	FY 2016A	FY 2017F	FY 2018F	FY 2019F
<b>Gross earnings</b>	<b>491,535</b>	<b>570,765</b>	<b>569,335</b>	<b>538,268</b>	<b>532,845</b>
Interest Income	395,162	405,281	475,114	443,912	439,817
Interest Expense	(129,997)	(100,839)	(146,734)	(141,549)	(141,403)
<b>Net interest income</b>	<b>265,165</b>	<b>304,442</b>	<b>328,380</b>	<b>302,364</b>	<b>298,414</b>
Non-Interest Revenue	96,373	165,484	94,221	94,356	93,028
OPEX	(222,775)	(220,933)	(224,944)	(237,802)	(250,250)
Provisions	(118,794)	(226,037)	(147,333)	(67,444)	(39,131)
<b>PBT</b>	<b>21,541</b>	<b>22,948</b>	<b>50,320</b>	<b>91,475</b>	<b>102,062</b>
Tax	(6,042)	(5,807)	(7,045)	(14,636)	(16,330)
<b>PAT</b>	<b>15,499</b>	<b>17,141</b>	<b>43,275</b>	<b>76,839</b>	<b>85,732</b>
<b>Balance Sheet (N '000) *</b>					
<b>Assets</b>					
Cash & Short-term funds	715,871	690,165	945,212	1,103,774	1,139,572
Net Loans	1,817,271	2,083,894	1,964,496	1,926,958	1,956,534
Fixed Assets	88,398	88,315	92,333	101,797	108,521
<b>Total Assets</b>	<b>4,166,189</b>	<b>4,736,805</b>	<b>4,963,452</b>	<b>5,185,268</b>	<b>5,353,260</b>
<b>Liabilities</b>					
Deposits	2,970,922	3,104,221	3,166,305	3,324,621	3,424,359
Borrowings	259,880	319,454	351,399	361,941	376,419
Total liabilities	<b>3,587,389</b>	<b>4,154,230</b>	<b>4,352,279</b>	<b>4,531,539</b>	<b>4,656,365</b>
Shareholders' fund	578,800	582,575	611,173	653,730	696,896
<b>Key Ratios</b>					
EPS	0.43	0.48	1.21	2.14	2.39
DPS	0.15	0.22	0.54	0.96	1.19
BVPS	16.12	16.23	17.03	18.21	19.41
P/B	11.88	7.02	4.79	2.70	2.42
ROE	2.81%	2.95%	7.25%	12.15%	12.70%
ROA	0.36%	0.39%	0.89%	1.51%	1.63%
Loans/Deposit	61%	67%	62%	58%	57%
Cost to income	62%	47%	53%	60%	64%
Liquidity ratio	36%	34%	38%	41%	42%
WACF	3.7%	2.8%	3.7%	3.4%	3.3%
Asset yields	12.5%	13.1%	14.3%	12.9%	12.3%
Cost of risk	6.5%	10.8%	7.5%	3.5%	2.0%
NPL	18.1%	24.9%	21.0%	18.0%	14.0%

Source: ARM Research \*unless otherwise stated

## 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
<b>STRONG BUY</b>	>20%	<b>BUY</b>	>20%
<b>OVERWEIGHT</b>	10% — 20 %	<b>NEUTRAL</b>	5% — 20 %
<b>NEUTRAL</b>	0% — 10 %	<b>SELL</b>	<5%
<b>UNDERWEIGHT</b>	-5% — 0%		
<b>SELL</b>	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
<b>BUY</b>	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
<b>OVERWEIGHT</b>	Accumulate security to an extent moderated by cognizance of its benchmark weight
<b>NEUTRAL</b>	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
<b>UNDERWEIGHT</b>	Minimise exposure to security taking cognizance of its index weighting
<b>SELL</b>	Sell-off security completely from portfolio

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