

Rating	<b>NEUTRAL</b>
Price	₦1.10
FVE	<b>₦1.27</b>
52-week range	₦0.92 - ₦1.55
Market Cap. (N'bn)	21.18
1-month Avg. Vol	2,081,417
Curr. PE	3.19x

Quarterly EPS	Q1	Q2	Q3	Q4
<b>2015 A</b>	0.27	0.15	(0.32)	0.15
<b>2016 A</b>	0.08	0.71	(0.14)	0.07
<b>2017A(E*)</b>	0.08	0.07	0.12	0.09*

#### FCMB.NL - Share Price Trend



#### Analyst(s)

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## FCMB Group Plc. (FCMB.NL)

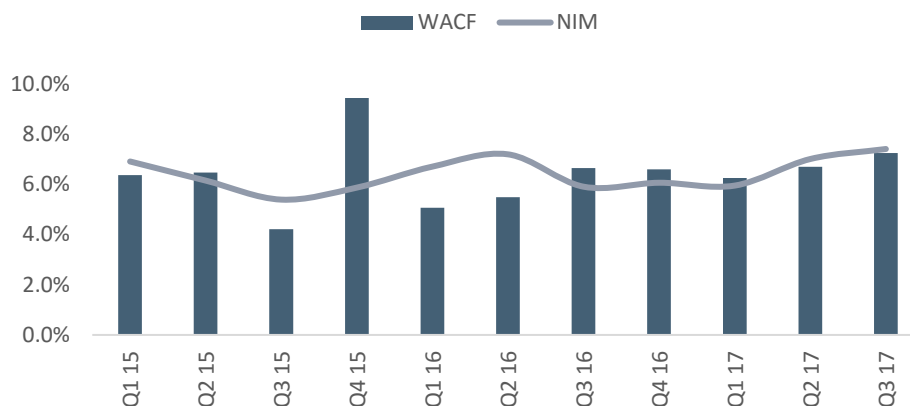
### Stock Report

#### *No 'Legacy' is so rich as Funding*

- At the start of the week, the management of FCMB hosted a conference call to review its nine-months 2017 result, provide guidance on outlook and update investors on its acquisition of Legacy Pension Managers. From the details provided, management intends to leverage on its holding of Legacy Pension (Legacy) to diversify the group's earnings and increase profitability. This aligns with our view in our recent report ***'Tier 2 Banks - Playing a catch-up game'*** where we forecast a growth in Legacy's contribution to the group's PBT from ~3% to 7% in FY 2018. Irrespective, we hold the view that a material change in FCMB's fortunes in the near term is contingent on its ability to combat funding cost pressures which resonates with the words of Williams Shakespeare 'No legacy is so rich as Honesty' or as Funding cost in the case of FCMB.
- Earnings weighed by funding cost and lower NIR.** FCMB's nine-months 2017 result was in line with our expectation. Interest expense of ₦46.4 billion (+15.8% YoY) grew faster than interest income (+3.3% YoY to ₦96.3 billion) to drive net interest income lower by 6.2% YoY to ₦49.9 billion. Further down, the impact of a high-base in Non-Interest Revenue (NIR) for 9M 2016, which captured ₦35.3 billion in foreign exchange gain, marred NIR in the review period (-58% YoY to ₦18.7 billion). Consequently, despite lower loan-loss provision (-63% YoY to ₦12.3 billion) and flat operating expenses, the impact of higher funding cost and lower NIR drove a 58% decline in EPS to ₦0.28 (9M 2016: ₦0.66).

- That said, the breakdown of standalone Q3 17 results reveal improvement in core performance. In the review quarter, interest income of ₦39.4 billion (+3.8% YoY) outpaced funding cost (+3% YoY) to drive a 4.5% increase in net interest income. Consequently, Net Interest Margin (NIM) expanded 1.5pps YoY (+0.4% QoQ) to 7.4%. More so, despite the absence of sizeable FX gains which underpinned lower NIR in the quarter, FCMB reported robust fee income (+34% YoY) and trading income (+49% YoY). Against this backdrop and markedly lower loan-loss provision of ₦2.7 billion (Q3 2016: ₦21 billion), FCMB reported PAT of ₦2.5 billion relative to loss after tax in Q3 2016 of ₦2.7 billion.

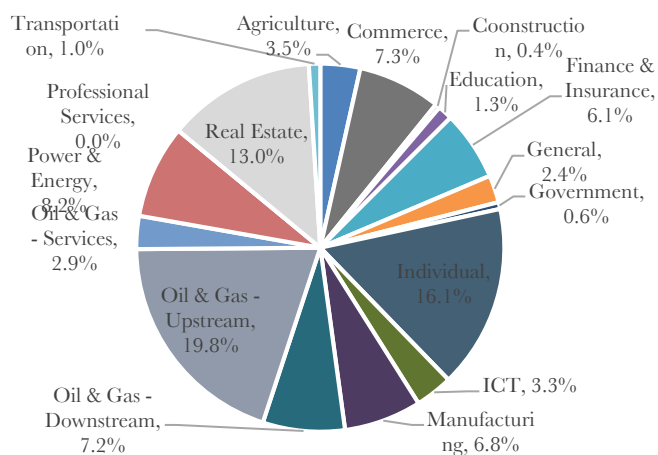
**Figure 1: Trend in NIM and Funding cost (WACF)**



Source: Company Financials, ARM Research

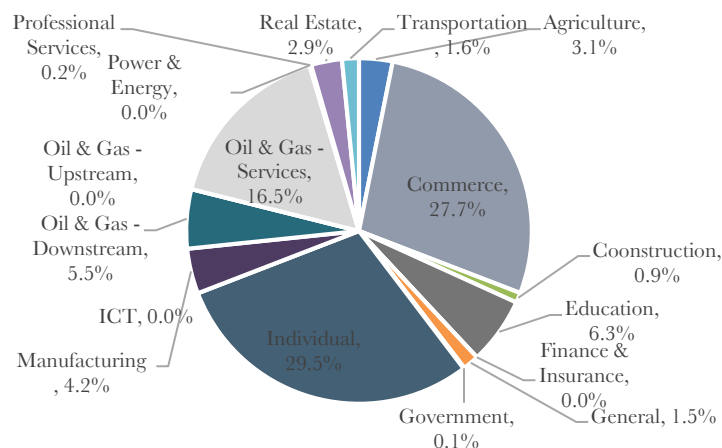
- O&G and Commerce mar asset quality.*** In the review quarter, asset quality deteriorated with NPL ratio rising 130bps to 4.7%. Breakdowns provided by FCMB links the sharp deterioration in asset quality to the O&G Downstream (4.6x YoY), O&G Services (25.5x YoY) and Commerce (50.8% YoY) sectors even as Education, Manufacturing and Transport also posed mild quality concerns. Across these sectors, FCMB states that a prudent stance informed increased provisioning for NPLs with coverage ratio at 108.2% for its entire NPL book. CAR improved by 90bps QoQ to 17.9%.

**Figure 2: Gross Loan composition by sector**



Source: Company Financials, ARM Research

**Figure 3: NPL Composition by Sector**



### **Key Takeaways from conference call.**

- **Liquidity.** Management confirmed the refund of prior excess CRR of ~~~₦~~30 billion (est. ~~₦~~23 billion) in the third quarter which supported improvement in liquidity ratio to 35% (Q2 17: 30.1%) and interbank funding.
- **Loan Restructuring.** Management guided that 90% of loans to Upstream O&G sector has been restructured mainly by means of tenor extension in line with current cash flow. Also, 65% of loans to the power sector has been restructured to allow for timing with dollar sourcing as revenue are naira denominated.
- **NPL and provisioning.** Asset quality issues majorly stems from specific loans to the downstream and services segments of the O&G sector. Management guides to a marginal increase in loan-loss charge in Q4 17, though it is expected to remain well within guidance of 2.8% by FY 2017. No guidance on NPL was provided.
- **Exposure to 9mobile.** Due to the secured nature of FCMB's ~~₦~~4 billion exposure to 9mobile, management has made no specific provision on 9mobile but expects collective provision booked so far to cover any future need for specific provisioning.
- **Cost efficiency.** Management confirmed that its flat operating expenses despite AMCON levy stemmed from streamlining of its branches but guided to no further bank closure in the coming year.
- **Funding cost.** Management expects a mild loosening in monetary policy in 2018 to support moderation in funding cost and improve NIMs.

- **Legacy Pension Managers Acquisition.** According to management, additional 60% stake in Legacy was acquired for ₦6.96 billion.

Key Deal Highlights	
Number of shares acquired (million)	480
Value of shares purchased (₦billion)	6.96
Implied total equity value (₦billion)	11.56
60% of 2017 Annualised PAT (₦million)	485
60% of SHF as at Oct 2017 (₦billion)	1.92
FCMB's total stake	88.20%
Carrying value of total stake (₦billion)	7.35

#### **Revision to estimate.**

- Although FCMB's coverage ratio of >100% appears adequate, persisting concerns in the services and downstream segment of the Oil & Gas sector as well as economic contraction in the Commerce and Manufacturing sector (exposure of 7.3% and 6.8% respectively) remains a key risk to asset quality in the near term. In any case, FCMB's adequate provisioning limits scope for sharp increases in cost of risk from these sectors. In sum, we forecast NPL ratio of 5% and 4% for 2017 and 2018 respectively. The foregoing alongside management guidance raises our Cost of Risk estimate for 2017E and 2018F to 3.5% and 2.5% respectively. Consequently, loan-loss provision for 2017 and 2018 should print at ₦20.5 billion and ₦18.2 billion accordingly.
- That said, we have adjusted our funding base for the excess ₦6 billion from excess CRR refund relative to our ₦23 billion estimate. The foregoing increases our interest income for Q4 17 to ₦39.4 billion (+16% QoQ) while funding cost in the period is expected to print at ₦17.7 billion (+7.3% QoQ) to drive a 24% expansion in net interest income with corresponding margin (NIM) printing at 8.8% (1.3pps QoQ).
- Thus, with a focus on capturing higher yields on the naira curve, no plans to grow risky assets, lower loan-loss provisioning relative to prior year, increased prospects of recoveries, adequate capital buffer, and moderate funding cost pressures on the back of lower yield environment, downside risk to 2017 and 2018 earnings now seems moderated than was earlier expected. In all, we forecast FY 17 EPS of ₦0.36 (previously ₦0.55) which is 49% lower YoY. Excluding FX gains in prior year, FY 17 EPS should be four-fold higher YoY. Adjustment to earnings bring DPS at ₦0.07 (previously ₦0.11). Over 2018, we forecast EPS of ₦0.92 (+153% YoY) and DPS of ₦0.18. Net impact of our revision lowers our FVE for FCMB by 6% to **₦1.27** which translates to a **NEUTRAL** rating on FCMB. The stock trades at a current P/B of 0.1x relative to peer average at 0.2x.

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

Income Statement	2013A	2014A	2015	2016E	2017E	2018E	2019E
<b>Gross earnings</b>	129,757	148,637	152,508	176,352	161,722	165,738	177,810
<b>Interest Income</b>	101,640	117,984	123,584	125,109	135,697	138,331	148,450
<b>Interest Expense</b>	(45,507)	(45,351)	(59,647)	(55,576)	(64,093)	(54,955)	(58,341)
<b>Net interest income</b>	56,134	72,634	63,937	69,534	71,604	83,377	90,110
<b>Non-Interest Revenue</b>	28,116	28,185	25,760	47,741	26,025	27,406	29,359
<b>OPEX</b>	(58,151)	(66,304)	(66,979)	(65,774)	(68,760)	(71,161)	(74,374)
<b>Provisions</b>	(7,983)	(10,640)	(15,033)	(35,522)	(20,520)	(18,240)	(17,264)
<b>PBT</b>	18,184	23,943	7,769	15,979	8,349	21,382	27,831
<b>Tax</b>	(2,183)	(1,810)	(3,008)	(1,913)	(1,169)	(3,207)	(4,453)
<b>PAT</b>	16,001	22,133	4,761	14,066	7,180	18,175	23,378
<b>Balance Sheet</b>							
<b>Assets</b>							
<b>Cash &amp; Short-term funds</b>	273,173	272,399	306,474	247,566	259,890	270,286	286,503
<b>Net Loans</b>	450,533	617,980	592,957	659,937	683,991	729,591	784,728
<b>Fixed Assets</b>	26,812	28,392	29,971	32,283	32,187	34,641	37,464
<b>LT investment</b>	214,155	202,099	187,088	187,549	207,990	214,230	224,942
<b>Total Assets</b>	1,008,280	1,169,365	1,159,534	1,163,624	1,249,986	1,319,651	1,412,420
<b>Liabilities</b>							
<b>Deposits</b>	715,214	733,797	700,217	657,610	739,884	797,255	868,810
<b>Borrowings</b>	60,627	140,743	196,906	228,793	215,120	221,574	228,221
<b>Other liabilities</b>	84,363	125,258	90,993	79,778	79,778	79,778	79,778
<b>Total liabilities</b>	864,573	1,008,999	997,143	993,908	1,038,584	1,102,434	1,180,664
<b>Shareholders' fund</b>	143,707	160,365	162,391	169,716	211,401	217,217	231,757
<b>Key Data &amp; Ratios</b>							
<b>EPS</b>	0.81	1.12	0.24	0.71	0.36	0.92	1.18
<b>DPS</b>	-	0.25	0	-	0.07	0.18	0
<b>BVPS</b>	7.26	8.10	8.20	8.57	10.68	10.97	11.70
<b>Asset yields</b>	11.4%	11.6%	11.3%	11.5%	12.1%	11.7%	11.8%
<b>WACF</b>	6.3%	5.5%	6.7%	6.1%	6.9%	5.6%	5.5%
<b>ROE</b>	11.6%	14.6%	3.0%	8.5%	3.8%	8.5%	10.4%
<b>ROA</b>	1.7%	2.0%	0.4%	1.2%	0.6%	1.4%	1.7%
<b>Financial leverage</b>	701.6%	729.2%	714.0%	685.6%	591.3%	607.5%	609.4%
<b>Loan to Deposits</b>	63.0%	84.2%	84.7%	100.4%	92.4%	91.5%	90.3%
<b>Cost to income</b>	69.0%	65.8%	74.7%	56.1%	70.4%	64.2%	62.3%
<b>Cost of risk</b>	1.8%	1.7%	2.5%	5.4%	3.0%	2.5%	2.2%
<b>NPL</b>	3.9%	3.6%	4.2%	4.5%	5.0%	4.0%	3.5%
<b>CAR</b>	17.5%	19.3%	16.9%	22.2%	22.3%	21.7%	21.7%

Source: ARM Research \*unless otherwise stated

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