

FCMB Group Plc. | Earnings Report

9 months ended 30th September, 2016

Impairment spike swings earnings negative
(NEUTRAL: ₦1.10)

- After an interim audit-induced delay, FCMB Group Plc. (FCMB) released its 9M 16 results. Flattered by base effects, PBT and PAT printed at ₦14 billion (9M 15: ₦2.6 billion) and ₦12.9 billion (9M 15: ₦1.9billion) respectively.

Deterioration in O&G and Consumer loan book drives surge in loan loss charge

- In a replay of 2015, when FCMB's interim audit in Q3 15 resulted in surge in loan loss charges, the bank reported a more than double QoQ jump in impairment charges to a nineteen-quarter peak of ₦21 billion. The development is in tandem with the deterioration in the macro environment with the NBS reporting that Nigeria's GDP contracted for the third consecutive quarter. FCMB links the upswing in provisions to issues in its O&G (27% of total loans) and impact of salary delays on Consumer loan book (20% of total loans).
- That said, NPL ratio dipped 130bps QoQ to 3.4% as FCMB took advantage of CBN's one-off forbearance on waiting one year to write-off fully provided loans. Absent this, FCMB estimates that NPL would be 6.8%.
- Consequently, annualized cost of risk spiked 6.7pps QoQ to 12.8% (9M 16: 7%, 2016E: 4.5%) with the elevated

Income Statement Data			
	2016 – 9M'm	2015 – 9M'm	%chg
Gross Earnings	140,727	109,294	28.8%
PBT	14,179	2,563	453.2%
Tax	(1,194)	(697)	71.2%
PAT	12,984	1,866	596.0%

Balance Sheet Data			
	2016-Sept 'm	2015 -Dec 'm	%chg
Cash	283,032	306,474	-7.6%
Loans	657,120	592,957	10.8%
Deposits	664,310	700,217	-5.1%
Fixed Asset	31,351	29,971	4.6%
Net Assets	174,878	162,391	7.7%

Stock Data	
Price	₦1.05
52-week range	₦0.68 – ₦1.99
Market Cap. (N'm)	20,793
1-month Avg. Vol	9,771,456
Curr. PE	1.3x
Bloomberg Ticker	FCMB:NL

FCMB Plc- Share Price Trend

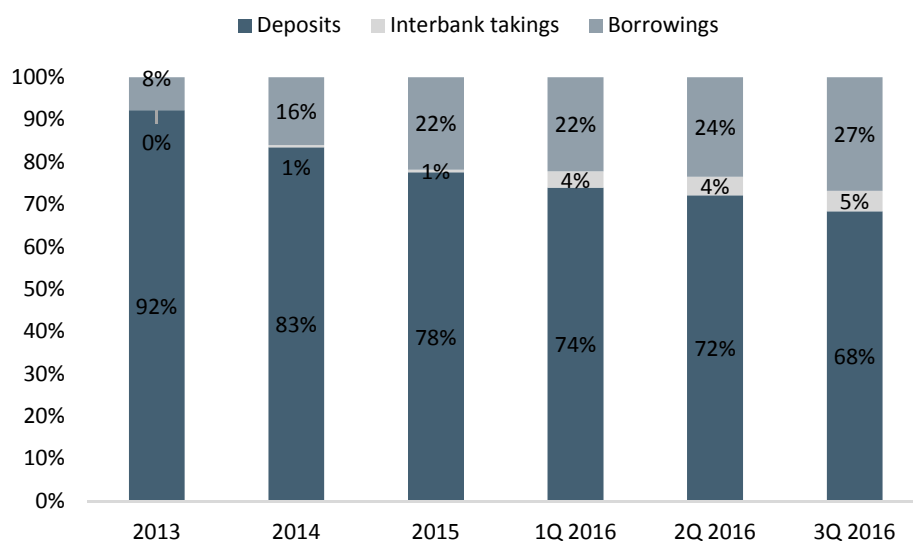
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provisioning largely accounting for pre-tax and post-tax loss of ₦2.1 billion and ₦2.7 billion respectively.

Slack growth across dual revenue streams

- Beyond the asset quality issues, FCMB's revenue lines disappointed with interest income rising only 2% QoQ to ₦32.7 billion (Q3 16E: ₦33.6 billion) and asset yields rising a tame 60bps QoQ (vs. 160bps across coverage peers over Q3 16). Given flat QoQ loan growth, management links the slower pick-up in asset yields to delayed loan repricing which occurred in early-to-mid September 2016. Elsewhere, as with the rest of the sector, non-interest revenue (NIR) shrank 9.8% QoQ to ₦18.8 billion in Q3 16, though this owed much to a ₦1.4 billion loss on asset disposal over the period.
- On the funding side, interest expense tracked higher (+27% QoQ to ₦16 billion, Q3 16E: ₦14.7 billion). Discussions with FCMB links the development to a deliberate move to get more stable borrowings (+16% QoQ), as elevated interest rates on Nigerian Treasury Bills was driving pressures on deposits which shrank 3.6% QoQ. Thus, annualized WACF climbed 120bps QoQ to 6.7% (9M 2016: 5.5%).

Figure 1: Components of funding Base



Source: Company financials, ARM Research

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- Despite the weak earnings, CAR climbed 150bps to 17.6% as FCMB consolidated prior earnings, leaving over 200bps buffer over regulatory CAR limit of 15% for its banking license category.

Negative surprise on impairment line drives downward revisions to earnings

- The weak Q3 16 results and adjustments to guidance trigger revisions to our estimates. First, we raise our cost of risk assumption to capture current run rate and management's new guidance (up 300bps to 7%). Given the persisting salary delay issues across several states and rising unemployment rate, we see pressures on FCMB's consumer loan book over Q4 16. Accordingly, we project 2016E impairment charges of ₦47.2 billion (2015: ₦15 billion).
 - Elsewhere, delays in upward loan repricing imply faster pick-up in asset yields over Q4 16 which informs our projection for a 15% QoQ rise in interest income to ₦37 billion in Q4 16E (2016E: +6% YoY to ₦130 billion). On interest expense, FCMB's move away from deposits to ensure stable funding, which drove the issuance of a ₦7.5 billion bond in November at 17% among other moves, should result in near term funding pressures. Consequently, we forecast Q4 16E interest expense 7% higher QoQ at ₦17 billion.
 - At the earnings call, FCMB noted it still held a \$200 million net long FCY position on its balance sheet implying that further NGN depreciation should translate to FX translation gains. Net impact of the changes to our estimates result in Q4 16E PBT and PAT of ₦2.1 billion and ₦1.7 billion respectively with FY 16E EPS at ₦0.74. Beyond 2016, we raise our views regarding annualized WACF as we think FCMB's push for borrowings should drive elevated funding cost pressures. Furthermore, lower NGN depreciation should underpin tamer NIR over 2017.
 - Post adjustments, our FVE for FCMB slides to ₦1.10 (vs. ₦1.90 previously) relative to last trading price of ₦1.05. FCMB share price has declined 38% YTD with valuation multiples (P/B: 0.1x, P/E: 1.3x) at discount to peers (P/B: 0.4x, P/E: 4x). We place a **NEUTRAL** recommendation on the stock.
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Summary of Results and Forecasts

QUARTERLY

Income Statement
(₹' million)*

	Q1 2016A	Q2 2016A	Q3 2016A	Q4 2016E
Gross earnings	34,362	53,920	52,444	48,452
Interest Income	28,505	32,045	32,686	37,459
Interest Expense	(11,346)	(12,660)	(16,033)	(17,084)
Net interest income	17,159	19,385	16,653	20,375
Non-Interest Revenue	5,093	20,874	18,834	13,683
OPEX	(16,513)	(16,221)	(16,588)	(16,731)
Provisions	(3,532)	(9,957)	(21,008)	(12,701)
PBT	2,207	14,081	(2,110)	4,626
Tax	(562)	(59)	(574)	(686)
PAT	1,645	14,023	(2,684)	3,940

ANNUAL

Income Statement
(₹' million)*

	FY 2014A	FY 2015A	FY 2016E	FY 2017F	FY 2018F
Gross earnings	148,637	152,508	189,179	169,988	177,799
Interest Income	117,984	123,584	130,695	134,137	140,272
Interest Expense	(45,351)	(59,647)	(57,123)	(52,236)	(54,955)
Net interest income	72,634	63,937	73,572	81,901	85,317
Non-Interest Revenue	28,185	25,760	58,484	35,851	37,527
OPEX	(66,304)	(66,979)	(66,053)	(68,728)	(71,678)
Provisions	(10,640)	(15,033)	(47,198)	(34,381)	(29,184)
PBT	23,943	7,769	18,805	14,644	21,983
Tax	(1,810)	(3,008)	(1,880)	(1,757)	(3,078)
PAT	22,133	4,761	16,924	12,887	18,905

Balance Sheet
(₹' million) *

Assets					
Cash & Short term funds	272,399	306,474	245,179	259,890	270,286
Net Loans	617,980	592,957	674,259	687,610	729,591
Fixed Assets	28,392	29,971	30,637	32,187	34,641
LT investment	202,099	187,088	207,990	207,990	214,230
Total Assets	1,169,365	1,159,534	1,241,425	1,291,992	1,366,796
Liabilities					
Deposits	733,797	700,217	692,501	739,884	797,255
Borrowings	140,743	196,906	226,442	215,120	221,574
Total liabilities	1,008,999	997,143	1,073,879	1,109,721	1,173,571
Shareholders' fund	160,365	162,391	167,546	182,270	193,224

Key Ratios	FY 2014A	FY 2015A	FY 2016F	FY 2017F	FY 2018F
EPS	1.12	0.24	0.85	0.65	0.95
DPS	0.25	0.10	0.11	0.10	0.19
BVPS	8.10	8.20	8.46	9.20	9.76
Asset yields	11.6%	11.3%	11.8%	11.8%	11.8%
WACF	5.5%	6.7%	6.3%	5.6%	5.6%
ROE	14.6%	3.0%	10.3%	7.4%	10.1%
ROA	2.0%	0.4%	1.4%	1.0%	1.4%
Financial leverage	7.29	7.14	7.41	7.09	7.07
Loan to Deposits	84.2%	84.7%	97.4%	92.9%	91.5%
Cost to income	65.8%	74.7%	50.0%	58.4%	58.3%
Cost of risk	1.7%	2.5%	7.0%	5.0%	4.0%
NPL	3.6%	4.2%	4.5%	5.0%	4.0%
CAR	19.3%	16.9%	17.2%	18.2%	18.3%

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
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	Minimise exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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