

**FCMB Group Plc. | Company Note**
**FCMB Plc: A forgotten star?**
**(BUY: ₦1.34)**

- Following a dramatic share price decline (-23% from the year-peak of ₦1.42), FCMB now looks attractively valued among our Tier 2 coverage and thus offers legroom for tactical play. The bank trades at a P/B of 0.1x compared to peer average of 0.8x and its FY 17E P/E of 1.8x is at a sizable discount to peer average of 3.9x and its current P/E of 7.6x. Furthermore, at current pricing, its 2017E dividend translates to dividend yield of 10.5%. While we believe higher funding cost and a relatively illiquid balance sheet are valid reasons why FCMB's earnings should struggle, we believe the market has over punished the stock relative to Tier II peers which have rallied 30% YTD. Ahead of Q3 17 results, we think current pricing offers a window for tactical plays and rate the stock a BUY with FVE of ₦1.34 (25% upside from current pricing) with a view that fundamentals will improve through H2 2017.

**High base effect casts H1 17 result in poor light**

- H1 17 results illuminates two key reasons why investors have been lukewarm towards the stock of FCMB. First, EPS of ₦0.15 is down 81% YoY largely on the back of a weighty decline in non-interest income (-50% YoY). In addition to this, the bank faced sizable funding cost pressure (interest expense: +24% YoY) in the review period.

Income Statement Data			
	2017 – 6M'm	2016 – 6M'm	%chg
<b>Gross Earnings</b>	77,508	88,283	-12.2%
PBT	3,716	16,289	-77.2%
<b>PAT</b>	2,911	15,668	-81.4%
EPS	0.15	0.79	-81.4%
Balance Sheet Data			
	2017- 6M 'm	2016 -Dec 'm	%chg
<b>Loans</b>	649,199	657,021	-1.2%
<b>Total Assets</b>	1,177,322	1,286,546	-8.5%
<b>Deposits</b>	633,477	689,345	-8.1%
<b>Total liabilities</b>	996,920	1,108,947	-10.1%
<b>Net Assets</b>	180,402	177,599	1.6%
<b>BVPS</b>	9.11	8.97	1.6%
Stock Data			
<b>Price</b>	₦1.07		
<b>52-week range</b>	₦0.90 – ₦1.42		
<b>Market Cap. (N'Bn)</b>	21.19		
<b>1-month Avg. Vol</b>	5,988,962		
<b>Curr. PE</b>	7.6x		
<b>Bloomberg Ticker</b>	FCMB:NL		

**FCMB Plc- Share Price Trend**

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On the former, despite an over three-fold expansion in trading income, lower FX gains (-97% YoY) dampened non-interest income.<sup>1</sup> Adjusted for FX gains, H1 17 non-funded revenues are 83% higher YoY.

- Elsewhere, as a Tier II bank, FCMB buckled under the weight of monetary tightening with WACF rising 45bps to 6.7% due to high term-deposit (+2pps YoY to 32% of total deposit) as well as higher interbank lending. Interestingly, this was synonymous across our Tier II coverage.

#### *Liquidity bolstering and better asset quality to spur earnings*

- In our discussion with FCMB, management revealed plans to address balance sheet inflexibility by focusing asset creation on its investment securities portfolio to harvest the current high yields on government treasury bills. Furthermore, FCMB expects a CRR refund of ~₦23billion in H2 2017, which would improve its balance sheet and earnings capacity. Consequently, despite lingering pressures from funding (FY 17E WACF: +50bps YoY to 6.6%), we expect NIMs to remain flat as with H1 17. The foregoing brings FY 17E interest expense to ₦61.9billion (+11.3% YoY). Laying our funding cost assumption with FY 17E asset yield of 11.9% (interest income: 8.9% YoY to ₦136.3billion), we now expect NIM to come in at 6.5% (+30bps YoY). In our view, we expect an improved liquidity picture for FCMB over the rest of the year given reduction in loan as well as potential inflow from CRR refund.
- On NIR, we expect improving FX market activity to drive an expansion in trading income (+18% YoY) while card revenues should recover as banks raise limits on international card usage which should buoy net fee income (+14% YoY) in our view. However, largely reflecting the softer NGN depreciation relative to 2017, we expect weighty decline in other income (-61% YoY)—a reflection of lower FX gains—to keep NIR lower at ₦33.2billion for FY 17E (-30.5% YoY).
- In line with the rest of the sector, net loans declined (-1% QoQ) in line with concerns over conserving capital, a cautious approach towards loan origination and ongoing work-out of its loan book. Given, adequate provisioning over 2016 and H1 17, alongside improvement in the economic environment, we see scope for lower

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<sup>1</sup> H1 16 NIR was buoyed by NGN depreciation which drove ₦18.3billion in FX gains over the period.

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provisioning in FY 17E. Importantly, higher coverage is driven by adequate coverage ratio for non-performing loans as well as challenged sectors (O&G, Power, Commerce, and Individual). Consequently, we forecast coverage ratio of 100% (excl. regulatory reserve) and cost of risk of 3.5% (management guidance: 3%) which results in a 30% YoY decline in loan loss charges to ₦24.9billion in FY 17E.

#### *Sustained recovery to drive decent FY 17E*

- Therefore, with a focus on capturing higher yields on the naira curve, no plans to grow risky assets, lower loan-loss provisioning, increased prospects of recoveries, operational efficiency, and adequate capital buffer, downside risk to 2017 earnings now seems moderated than was earlier expected. Overall, we forecast 2017E EPS of ₦0.55 (-22% YoY) and DPS of ₦0.11. However, excluding FX gains in prior year, FY 17 EPS should be four-fold higher YoY. Our FVE of ₦1.34 posit a 25% upside from current pricing. Consequently, we rate the stock a **BUY**, reflecting attractive valuation and a view that fundamentals will improve through H2 2017 and beyond despite period of lumpiness. Furthermore, across the Tier 2 space, FCMB remains a more resilient bank (save for Stanbic) with key metrics printing above peer average.
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## Summary of Results and Forecasts - Naira (₦)

<b>ANNUAL</b>						
Income Statement (₦'000) *	FY 2015A	FY 2016A	FY 2017F	FY 2018F	FY 2019F	
<b>Gross earnings</b>	<b>152,508</b>	<b>176,352</b>	<b>169,447</b>	<b>173,098</b>	<b>185,391</b>	
Interest Income	123,584	125,109	136,276	138,331	148,450	
Interest Expense	(59,647)	(55,576)	(61,873)	(54,955)	(58,341)	
<b>Net interest income</b>	<b>63,937</b>	<b>69,534</b>	<b>74,403</b>	<b>83,377</b>	<b>90,110</b>	
<b>Non-Interest Revenue</b>	<b>25,760</b>	<b>47,741</b>	<b>33,171</b>	<b>34,767</b>	<b>36,941</b>	
OPEX	(66,979)	(65,774)	(69,872)	(72,585)	(75,885)	
Provisions	(15,033)	(35,522)	(24,960)	(20,647)	(19,854)	
<b>PBT</b>	<b>7,769</b>	<b>15,979</b>	<b>12,742</b>	<b>24,911</b>	<b>31,312</b>	
Tax	(3,008)	(1,913)	(1,784)	(3,737)	(5,010)	
<b>PAT</b>	<b>4,761</b>	<b>14,066</b>	<b>10,958</b>	<b>21,174</b>	<b>26,302</b>	
<b>Balance Sheet (₦ '000) *</b>						
<b>Assets</b>						
Cash & Short-term funds	306,474	247,566	259,890	270,286	286,503	
Net Loans	592,957	659,937	687,610	729,591	784,728	
Fixed Assets	29,971	32,283	32,187	34,641	37,464	
LT investment	187,088	187,549	207,990	214,230	224,942	
<b>Total Assets</b>	<b>1,159,534</b>	<b>1,163,624</b>	<b>1,249,713</b>	<b>1,322,439</b>	<b>1,417,607</b>	
<b>Liabilities</b>						
Deposits	700,217	657,610	739,884	797,255	868,810	
Borrowings	196,906	228,793	215,120	221,574	228,221	
Other liabilities	90,993	79,778	79,778	79,778	79,778	
<b>Total liabilities</b>	<b>997,143</b>	<b>993,908</b>	<b>1,038,584</b>	<b>1,102,434</b>	<b>1,180,664</b>	
Shareholders' fund	<b>162,391</b>	<b>169,716</b>	<b>211,128</b>	<b>220,004</b>	<b>236,944</b>	
<b>Key Ratios</b>						
EPS	0.24	0.71	0.55	1.07	1.33	
DPS	0.10	-	0.11	0.21	0.40	
BVPS	8.20	8.57	10.66	11.11	11.97	
Asset yields	11.3%	11.5%	12.1%	11.7%	11.8%	
WACF	6.7%	6.1%	6.6%	5.6%	5.5%	
ROE	3.0%	8.5%	5.8%	9.8%	11.5%	
ROA	0.4%	1.2%	0.9%	1.6%	1.9%	
Financial leverage	7.14	6.86	5.92	6.01	5.98	
Loan to Deposits	84.7%	100.4%	92.9%	91.5%	90.3%	
Cost to income	74.7%	56.1%	65.0%	61.4%	59.7%	
Cost of risk	2.5%	5.4%	3.6%	2.8%	2.5%	
NPL	4.2%	4.5%	5.0%	4.0%	3.5%	
CAR	16.9%	22.1%	22.2%	21.9%	22.1%	

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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