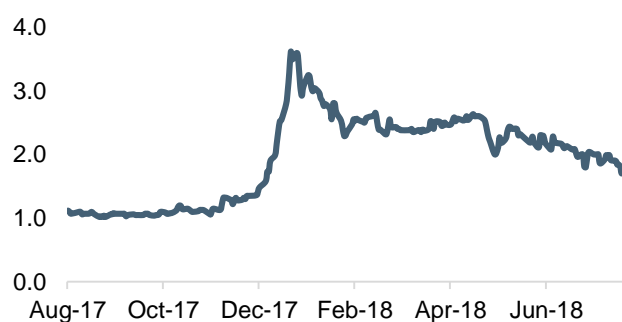




Rating	BUY
Price	₦1.90
FVE	₦2.34
52-week range	₦1.00 – ₦3.65
Market Cap. (₦mn)	37,625
1-month Avg. Vol	4,969,439
Curr. PB	0.21x

FCMB.NL - Share Price Trend



Analyst(s)

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H1 2018 Initial View: Strong Set of H1 Results

FCMB Plc. (FCMB.NL)

Stock Report

Credit shrink informs revision to 2018 estimate

- In this note, we transfer primary coverage of First City Monument Bank (FCMB) Plc. to **Emmanuel Adeleke**.
- FCMB half-year result saw earnings jump 90% YoY to ₦0.29/share on the back of moderation in funding cost (-44 bps YoY to 6.0%), strong Non-Interest-Revenue (+28% YoY) and a substantial decline in loan-loss provision (-27% YoY to ₦7.3 billion). However, some key line items came in as a surprise. To be specific, loan growth (-9% YTD) was below our expectation of 0.7% YoY growth. Also, operating expense (OPEX) ran ahead of our estimates (+3.6% deviation) due to higher AMCON charge (+75% YoY) while NIR came in lower than expected (-4.4% deviation).
- Following engagement with management, we made some changes to our estimate for 2018. To be specific, we now model a 6% decline in loan book (previously +0.7% YoY) following current run rate of a 9% decline. Furthermore, we revise the bank's Non-Performing Loan (NPL) ratio higher to 5.6%¹ (H1 18: 5.7%) due to higher NPL exposure to Oil & Gas downstream. We also adjust our forecast for NIR slightly lower to ₦34.6 billion (previously ₦35.1 billion). Lastly, we revise our operating expenses slightly higher by 2.8% to reflect higher AMCON charge. That said, key drivers for 2018 earnings remain strong NIR, lower funding cost and loan-loss provision. Net impact of our adjustment translates to an EPS of ₦0.55 (previously ₦0.87) in FY 2018 with our FVE revised lower to ₦2.34 (previously ₦3.38).

¹ previously 4.6%

-
- Nonetheless, we maintain our **BUY** rating on the stock. FCMB trades at a FY 18E P/B of 0.18x, at a discount to Tier 2 average of 0.20x.
 - At current price, our expected dividend of ₦0.10 over FY 18E translates to a dividend yield of 5.3%.

Key take-away from Conference Call

- **Non-Performing Loan.** Higher NPL in Oil & Gas downstream in H1 18 reflected delayed payment by the FG to oil marketers. However, management hinted there is a high prospect of recovery given that the Senate has approved payment.
- **Trading Income.** Jump in trading income over the quarter was because of management's deliberate decision to increase government assets. To buttress, significant pay downs in loans that was recorded over H1 18 was held into trading assets. Management will be looking out for opportunities in the market to trade and further increase trading income.
- **Regulatory charges.** Impact of CRR and AMCON charges costs about ₦20 billion every year on earnings.
- **Capital Raise.** There is no plan for Tier 1 capital raise, but the bank might consider a tier 2 capital raise depending on market condition. In short, management hinted at them looking for opportunities to get efficiently priced debt.

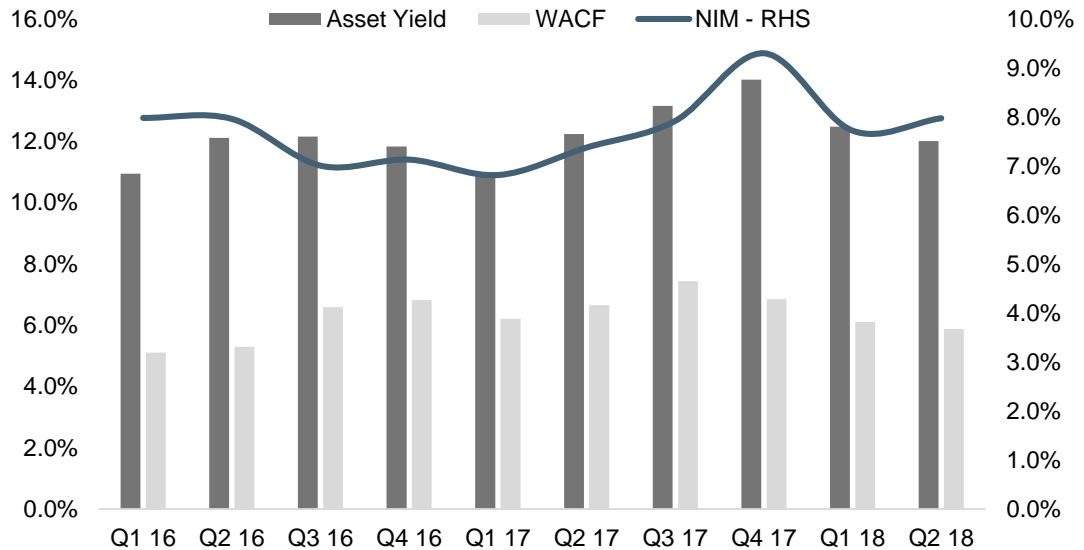
Revision to loan book on higher repayment and cautious stance

- We maintain our positive stance on deposit growth over 2018. To be specific, we expect deposit growth of 7% YoY to ₦741 billion (H1 18: +4.6% YTD). On loans, management pointed to significant pay downs in the Oil & Gas and Real Estate sectors as the drivers for the contraction in loan book which they expect will continue into Q3 18. In Q4 18, management guides to a pick-up in loan growth which will be directed largely to the consumer sector. However, we do not expect any possible increase to offset the decline recorded in H1 18 (-9.8% YTD). We therefore model a 6% decline in loan book over FY 2018 (H1 18: -9.8% YTD). Consequently, loan-to-deposit ratio should print at 82.4% over FY 2018 (H1 18: 81.2%, FY 17: 94.2%). With management's cautious approach to risk creation, this should cascade into higher investment securities over 2018 (+12% YoY to ₦240.5 billion).

Lower funding cost to moderate impact of lower yields on NIMs

- We expect the impact of lower funding cost over 2018 to moderate the decline in Net Interest Margin (-14 bps YoY to 6.3%). Importantly, we believe interest expense on borrowings from bank should remain tepid over the rest of the year given the improved liquidity position² of the bank. That said, asset yield is expected to moderate to 11.8% over FY 18 (H1 18: 11.7%, FY 17: 12.2%) on the back of the relatively lower yield environment.

Figure 1: Trend in funding cost, asset yields and NIMs



Source: Company Financials, ARM Research

Fee and Trading Income to boost NIR

- For non-interest revenue (NIR), we see support from both fee and trading income leg. On the former, we see sizable gains from digital banking and its asset management business. For emphasis, the bank has come up with new initiatives to drive income, one of which is its digital lending platform it launched in H1 18 which largely drove fee income over the period. We expect this momentum to be sustained over the rest of the year. Elsewhere, we expect income from the asset management business to contribute circa 14% to PBT in 2018 (2017: 2%), coming largely from its stake in Legacy Pension. On trading income, management's drive to increase trading assets should provide support for treasury-bills trading income. On balance, NIR should expand 8% YoY to ₹34.6 billion.

² H1 17: 30.1%, H1 18: 40.6%)

Lower impairment charge to support earnings

- As mentioned earlier, we revise our forecast of NPL ratio higher to 5.6% (FY 17: 4.9%, FY 19: 5.0%) due to higher NPL exposure to the Oil & Gas downstream sector and contraction in loan book. The higher NPL exposure to the Oil & Gas downstream sector reflects delayed payment to oil marketers by the FG. Although, the Senate has approved this payment, we choose to be conservative due to the bureaucratic nature of disbursement of funds by the FG. Furthermore, we revise Cost of Risk (CoR) slightly higher to 2.5% (FY 17: 3.5%, H1 18: 2.5%) from 2.3%. Lastly, factoring our expectation of about ₦5 billion in loan recoveries in 2018, we expect a 33% YoY decline in loan loss provision to ₦15.3 billion.
- Elsewhere, we project additional 2.8% increase in operating expenses to ₦74.2 billion (FY 17: ₦68.7 billion, FY 19: ₦78.1 billion) reflecting higher AMCON charges with Cost-Income-Ratio printing at 72.2% (FY 17: 67.0%).
- Net impact of our overall adjustment translates to a PBT of ₦13.5 billion over FY 18E. Thus, we estimate EPS of ₦0.55 (+15% YoY). Looking beyond 2018, major game changer to FCMB's earnings will stem from lower CRR and possible conclusion of AMCON charge after the 10-year term limit which is to end in 2020. Key risks to our valuation include liquidity pressure from higher CRR, and NPL ratio climbing higher. In the interim, we see ROE trading on single digits (FY 17: 5.7%, FY 18E: 5.5%, FY 19E: 7.7%, FY 20E: 8.4%). FCMB trades at a FY 18E P/B of 0.18x, which is at a discount to Tier 2 peers of 0.20x. At current price, our expected dividend of ₦0.10 over FY 18E translates to a dividend yield of 5.3%.

Figure 2: Loan Composition (H1 2018)

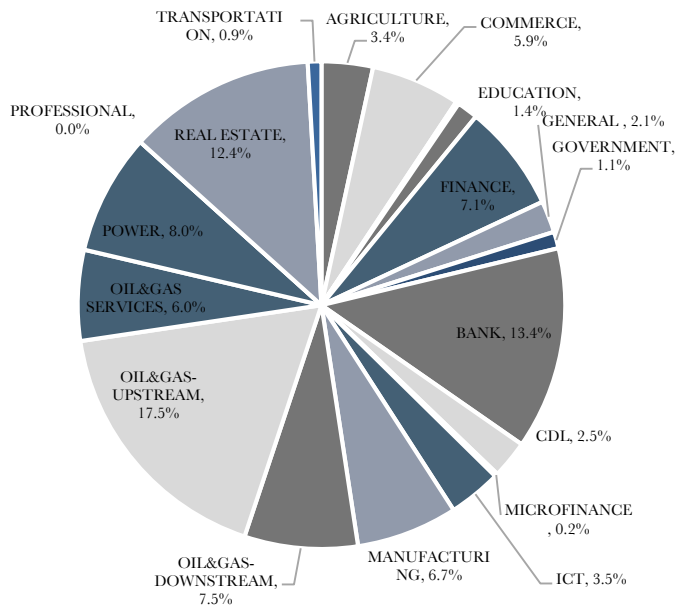
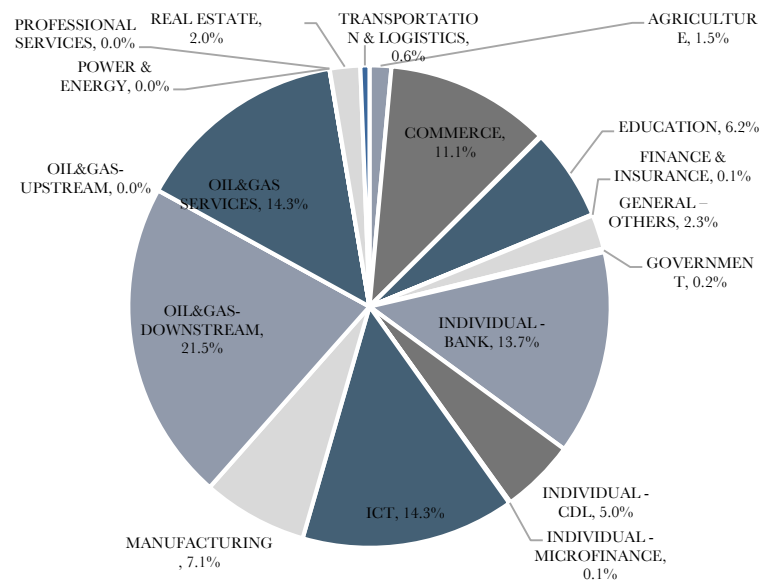


Figure 3: NPL Composition (H1 2018)



Summary of Results and Forecasts

Balance Sheet (¥ million)	2017	2018E	2019E	2020E	2021E
Assets					
Inv. Securities	214,759	240,530	252,556	270,235	289,152
Net loans	649,797	610,818	640,047	688,078	739,696
Gross loans					
Interest-earning assets	1,078,082	1,069,145	1,123,469	1,207,647	1,298,129
Total assets	1,162,243	1,191,490	1,260,647	1,356,020	1,450,407
Liabilities					
Interbank	6,355	12,711	13,982	15,380	16,918
Borrowings	206,731	147,410	150,358	168,401	171,769
Deposits	689,861	741,070	797,125	859,682	934,408
Interest-bearing liabilities	902,947	901,191	961,465	1,043,463	1,123,096
Total liabilities	997,212	995,455	1,055,730	1,137,728	1,217,360
Shareholders' Equity	165,032	196,035	204,917	218,293	233,047
Income Statement (¥ million)	2017	2018E	2019E	2020E	2021E
Interest Income	132,357	126,611	131,805	137,899	146,629
Interest Expense	(61,832)	(58,467)	(57,909)	(59,103)	(58,262)
Net Interest Income	70,525	68,143	73,896	78,796	88,368
Non Interest Revenue	32,117	34,598	38,333	41,176	44,284
Gross Earnings	169,882	161,208	170,137	179,075	190,913
Staff Costs	23,432	24,259	25,487	26,777	28,132
Other Costs	45,307	49,899	52,578	55,231	57,752
Total Costs	68,739	74,158	78,065	82,007	85,883
PBT	11,462	13,539	19,670	23,054	32,202
Provision Charge	(22,668)	(15,270)	(14,721)	(15,138)	(14,794)
Tax	(2,052)	(2,708)	(3,934)	(4,611)	(6,440)
Minorities	0	0	0	0	0
Net Profit	9,410	10,832	15,736	18,443	25,761
Dividend Paid	(1,980)	(1,950)	(2,360)	(3,689)	(5,152)
Key YoY growth rates (%)	2017	2018E	2019E	2020E	2021E
Loans	-1.5%	-6.0%	4.8%	7.5%	7.5%
Interest Earning Assets	-1.5%	-0.8%	5.1%	7.5%	7.5%
Deposits	4.9%	7.4%	7.6%	7.8%	8.7%
Interest Bearing Liabilities	-0.9%	-0.2%	6.7%	8.5%	7.6%
Assets	-0.1%	2.5%	5.8%	7.6%	7.0%
Gross Earnings	-3.7%	-5.1%	5.5%	5.3%	6.6%
Costs	4.5%	7.9%	5.3%	5.1%	4.7%
PBT	-28.3%	18.1%	45.3%	17.2%	39.7%
PAT	-33.1%	15.1%	45.3%	17.2%	39.7%
EPS	-33.1%	15.1%	45.3%	17.2%	39.7%

Per-share data (N)	2017	2018E	2019E	2020E	2021E
No of common shares (mn)	19,802,711	19,802,711	19,802,711	19,802,711	19,802,711
EPS	0.48	0.55	0.79	0.93	1.30
DPS	0.10	0.10	0.12	0.19	0.26
BVPS	8.33	9.90	10.35	11.02	11.77

Balance-sheet ratios (%)	2017	2018E	2019E	2020E	2021E
Loan/Assets	55.9%	51.3%	50.8%	50.7%	51.0%
Deposit/Liabilities	69.2%	74.4%	75.5%	75.6%	76.8%
Loans/Deposits	94.2%	82.4%	80.3%	80.0%	79.2%
Assets/Equity	7.04	6.08	6.15	6.21	6.22

Asset Quality	2017	2018E	2019E	2020E	2021E
NPLs	33,080	35,915	33,510	32,270	30,693
NPLs/Gross Loans (%)	4.9%	5.6%	5.0%	4.5%	4.0%
Credit change (%)					

Margins (%)	2017	2018E	2019E	2020E	2021E
Asset Yield	12.2%	11.8%	12.0%	11.8%	11.7%
WACF	6.8%	6.5%	6.2%	5.9%	5.4%
NIM	6.5%	6.3%	6.7%	6.8%	7.1%

Costs (%)	2017	2018E	2019E	2020E	2021E
Cost/Income	67.0%	72.2%	69.6%	68.4%	64.7%
Effective tax rate	17.9%	20.0%	20.0%	20.0%	20.0%

Profitability ratios (%)	2017	2018E	2019E	2020E	2021E
RoAE	5.6%	6.0%	7.8%	8.7%	11.4%
RoAA	0.8%	0.9%	1.3%	1.4%	1.8%

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
RESTRICTED	In certain circumstances, Asset & Resource Management ("ARM") Group policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of ARM Securities' and/or ARM Group's engagement in an investment banking transaction and in certain other circumstances.

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