

**Fidelity Bank Plc. | Earnings Report**


3 months ended 31<sup>st</sup> March, 2016

**Tamer asset yields and NIR weigh on revenue (FVE: ₦1.45)**

- Last week, Fidelity Bank Plc. (Fidelity) released its unaudited Q1 2016 numbers with gross earnings sliding 1.2% YoY to ₦33.9 billion. Though PBT declined 4% YoY decline to ₦4 billion, reported, lower effective taxes swung PAT 3% higher YoY to ₦3.6 billion.

**Lower asset yields mute impact of balance sheet expansion**

- Despite the weaker macro climate which is driving a pattern of loan-induced balance sheet shrinkage across Tier II peers, Fidelity reported an expansion in net loans (+2% QoQ to ₦590 billion) for the second consecutive quarter. Nonetheless, competitive pressures following the cutback in MPR in Q4 15 and lower yields on government securities combined to drive asset yields lower (QoQ: -390bps, YoY: -60bps). On balance, interest income declined 20% QoQ to ₦29.2 billion. However, reflecting successful low cost funding, Fidelity made the most of the lower rate environment to drive interest expense lower annualized WACF shrinking 170bps QoQ (+100bps YoY) to seventeen quarter low of 5.4%.
- Interestingly, despite the balance sheet expansion at a time when concerns about feed-through from the domestic landscape to asset quality abound, Fidelity continued to show better control on asset quality with provisioning reverting to subdued levels in Q1 16 (YoY: -

| Income Statement Data  |              |              |        |
|--|--------------|--------------|--------|
|  | 2016 – 3M'm  | 2015 – 3M'm  | %chg   |
| Gross Earnings   | 33,895       | 34,317       | -1.2%  |
| PBT  | 4,025        | 4,198        | -4.1%  |
| Tax  | 443          | 706          | -37.3% |
| PAT  | 3,582        | 3,492        | 2.6%   |
|  |              |              |        |
| Balance Sheet Data   |              |              |        |
|  | 2016-Mar 'm  | 2015 -Dec 'm | %chg   |
| Cash   | 240,948      | 185,332      | 30.0%  |
| Loans  | 590,133      | 578,203      | 2.1%   |
| Deposits   | 784,549      | 769,636      | 1.9%   |
| Fixed Asset  | 40,544       | 39,985       | 1.4%   |
| Net Assets   | 184,029      | 183,516      | 0.3%   |
|  |              |              |        |
| Stock Data   |              |              |        |
| Price  | ₦1.17        |              |        |
| 52 week range  | ₦1.08– ₦1.94 |              |        |
| Market Cap. (N'm)  | 33,886       |              |        |
| 1-month Avg. Vol   | 6,488,135    |              |        |
| Curr. PE   | 2.4x         |              |        |
| Bloomberg Ticker   | FIDELITY:NL  |              |        |
| Fidelity Bank Plc- Share Price Trend   |              |              |        |
|  |              |              |        |

**Analyst(s)**

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21%, QoQ: -60%) after the regulatory induced Q4 15 spike to cater for Oando exposures. Consequently, cost of risk declined 80bps QoQ (-20bps YoY) to 0.5%.

### **Restrictions on FX trading drive steep drop in NIR**

- In line with the sector wide pattern of shrinking NIR on lower FX incomes, Fidelity reported contraction in non-interest revenues (YoY: -35%, QoQ: -3%) to ₦4.7 billion with breakdowns provided isolating strong declines in net foreign exchange gains (YoY: -96%, QoQ: -85%) to ₦180 million as underpin for the NIR pressures. Despite the benefits of cheaper funding, the NIR pressures weighed on operating income (-2.9%). Largely driven by higher branding costs, opex rose 11% to ₦16 billion resulting in CIR deteriorating to 77% (+370bps, FY 15: 76%)

### **Nonetheless, robust capital buffers and valuation discounts support BUY rating**

- Going forward, recent hawkish twist to monetary policy raises prospect for stronger asset yields in subsequent quarters which, together with loan book growth, points to stronger interest income (FY 16E: +2% YoY to ₦124billion). For NIR, subsisting curbs on trading and recent review to bank charges, which Fidelity views as largely net negative points to subdued reading on the line item over 2016. (FY 16E: -2% YoY to ₦22.5billion)
  - On the costs side, the rate outlook points to a return in interest expense pressures, which Fidelity faced over much of 2015 (WACF: +40bps YoY to 6.5%) though rising share of CASA deposits could help temper scale of funding pressures (FY 16E: WACF: +10bps YoY to 6.6%). Elsewhere, management guides to greater cost control, as brand related costs decline in H2 16 and other cost optimization initiatives kick-in which Fidelity estimates should result in 5% YoY cutback in opex. As with the sector in 2016, asset quality concerns remain pivotal though, recent recovery in oil prices which are now above the mean break-even of \$42/bbl on Fidelity's book eases some concerns for the segment (16.3% of loan book). Nonetheless, pressures from the weak landscape and fiscal struggles at state level point to increased delinquencies on consumer loan (11% of total) while sizable exposure to power (11% of loans), where Fidelity noted issues around cash flows,
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raise scope for higher provisioning in 2016. Our cost of risk assumption of 1.8% (2015: 1%) vs. management guidance of 1% has been adjusted to capture prospect for deterioration on this front.

- Whilst the net impact of our adjustments imply a drop in FY 16E earnings (PBT: -45% YoY, PAT: -54% YoY), moderation in provisioning from elevated levels in 2016E and funding cost improvement drive a recovery in Fidelity's earnings farther out our forecast horizon. Furthermore at 19.3%, Fidelity's CAR provides some cushion over regulatory threshold of 15% to cope under the pressured landscape.
  - On current pricing, both P/E and P/B of 2.4x and 0.2x at discount to sector averages at 3x and 0.3x respectively. Upside implied in our **FVE (₦1.45)** relative to last trading price of ₦1.17, translates to a **BUY** rating on Fidelity.
  - Away from the financials, fall-out of an ongoing EFCC investigation has resulted in the board appointing Mr. Mohammed Balarabe as Acting CEO subject to regulatory approvals. Mohammed Balarabe, who holds a BSc. in Accounting and Finance from Nottingham Trent University, England and an MSc. in Finance from the University of Lagos, was previously the Executive Director (North) and possesses 24 years banking experience across Retail, Corporate and Commercial banking.
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## Summary of Results and Forecasts - Naira (₦)

| QUARTERLY                 |           |           |           |           |           |
|---------------------------|-----------|-----------|-----------|-----------|-----------|
| Income Statement (N'000)* |           |           |           |           |           |
|                           | Q1 2016A  | Q1 2016E  | Q2 2016E  | Q3 2016E  | Q4 2016E  |
| Gross earnings            | 33,895    | 33,203    | 35,790    | 35,359    | 42,261    |
| Interest Income           | 29,204    | 28,449    | 31,519    | 28,886    | 35,233    |
| Interest Expense          | (13,100)  | (13,718)  | (15,172)  | (15,336)  | (17,569)  |
| Net interest income       | 16,104    | 14,732    | 16,347    | 13,550    | 17,663    |
| Non-Interest Revenue      | 4,691     | 5,068     | 5,295     | 6,223     | 5,939     |
| OPEX                      | (16,031)  | (14,096)  | (15,726)  | (15,412)  | (21,199)  |
| Provisions                | (739)     | (1,898)   | (1,132)   | (1,398)   | (6,254)   |
| PBT                       | 4,025     | 3,805     | 4,785     | 2,962     | (3,851)   |
| Tax                       | (443)     | (571)     | (718)     | (444)     | 578       |
| PAT                       | 3,582     | 3,235     | 4,067     | 2,518     | (3,274)   |
|                           |           |           |           |           |           |
| ANNUAL                    |           |           |           |           |           |
| Income Statement (N'000)* |           |           |           |           |           |
|                           | FY 2014A  | FY 2015A  | FY 2016F  | FY 2017F  | FY 2018F  |
| Gross earnings            | 130,055   | 144,189   | 146,612   | 157,414   | 168,198   |
| Interest Income           | 104,307   | 121,158   | 124,087   | 134,607   | 144,742   |
| Interest Expense          | (55,481)  | (60,294)  | (61,795)  | (62,615)  | (65,239)  |
| Net interest income       | 48,826    | 60,864    | 62,292    | 71,992    | 79,503    |
| Non-Interest Revenue      | 25,748    | 23,031    | 22,525    | 22,807    | 23,456    |
| OPEX                      | (54,753)  | (64,107)  | (66,434)  | (70,017)  | (75,105)  |
| Provisions                | (4,306)   | (5,764)   | (10,682)  | (7,639)   | (7,025)   |
| PBT                       | 15,515    | 14,024    | 7,701     | 17,144    | 20,828    |
| Tax                       | (1,719)   | 120       | (1,155)   | (2,572)   | (3,124)   |
| PAT                       | 13,796    | 14,144    | 6,546     | 14,572    | 17,704    |
| Balance Sheet (N'000)*    |           |           |           |           |           |
| Assets                    |           |           |           |           |           |
| Cash & Short term funds   | 258,131   | 185,332   | 194,599   | 204,329   | 214,545   |
| Net Loans                 | 541,686   | 578,203   | 593,472   | 636,563   | 702,523   |
| Fixed Assets              | 37,958    | 39,985    | 41,193    | 42,853    | 45,462    |
| LT investment             | 160,390   | 297,343   | 318,041   | 340,356   | 364,428   |
| Total Assets              | 1,187,025 | 1,231,722 | 1,257,800 | 1,315,478 | 1,385,706 |
| Liabilities               |           |           |           |           |           |
| Deposits                  | 820,034   | 769,636   | 793,464   | 833,488   | 883,497   |
| Taxation                  | 1,719     | 2,332     | 2,332     | 2,332     | 2,332     |
| Borrowings                | 124,521   | 151,406   | 149,074   | 156,527   | 164,354   |
| Total liabilities         | 1,013,914 | 1,048,206 | 1,069,702 | 1,117,179 | 1,175,015 |
| Shareholders' fund        | 173,111   | 183,516   | 188,098   | 198,299   | 210,691   |
| Key Ratios                |           |           |           |           |           |
| EPS                       | 0.47      | 0.55      | 0.23      | 0.50      | 0.61      |
| DPS                       | 0.18      | 0.16      | 0.07      | 0.15      | 0.18      |
| BVPS                      | 5.98      | 6.34      | 6.49      | 6.85      | 7.27      |
| ROE                       | 8.2%      | 7.8%      | 3.5%      | 7.5%      | 8.7%      |
| ROA                       | 1.2%      | 1.2%      | 0.5%      | 1.1%      | 1.3%      |
| Asset yields              | 12.4%     | 13.4%     | 12.8%     | 13.3%     | 13.2%     |
| WACF                      | 6.1%      | 6.5%      | 6.6%      | 6.5%      | 6.4%      |
| Cost of risk              | 0.8%      | 1.0%      | 1.8%      | 1.2%      | 1.0%      |
| Loan to Asset             | 46%       | 47%       | 47%       | 48%       | 51%       |
| Loan to deposits          | 66%       | 75%       | 75%       | 76%       | 80%       |
| Cost to income            | 73%       | 76%       | 78%       | 74%       | 73%       |
| Liquidity ratio           | 42%       | 25%       | 25%       | 25%       | 25%       |

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 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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