

## Non-interest Income Drives Earnings; FBN Writes off the Largest Non-Performing Loan

### INVESTMENT SUMMARY

The unaudited financial results released by the First Bank of Nigeria in the half year of 2019 remained almost flat with a marginal increase of 0.31% to ₦294.23 billion (vs. ₦293.34 billion in the half year of 2018). The slight increase in the gross earnings can be mainly ascribed to improved non-interest income during the period. Non-interest income rose by 3.60% to ₦63.60 billion in H1'19 (vs. ₦61.30 billion in H1'18) due to higher fee & commission. However, as a result of lower interest income from loans and deposits, total interest income fell by 1.61% to ₦221.78 billion in the half year to June 2019, from ₦225.40 billion reported in the corresponding period of the previous year. Due to lower cost of funds in the half year of 2019, total interest expenses declined marginally by 0.93% to ₦75.06 billion (vs. ₦75.76 billion in the half year of 2018). Meanwhile, operating expenses increased by 24.33% to ₦148.29 billion in H1'19 (vs. ₦119.27 billion in H1'18) due to higher personnel expenses, higher regulatory and advert & corporate promotions expenses. Impressively, the bank's single largest NPL (Atlantic Energy) was written off and this translated to a lower NPL ratio of 14.5% (H1'18: 20.80%) and a lower impairment charge of ₦22.11 billion in H1'19 (vs. ₦52.81 billion in H1'18).

The higher non-interest income and lower impairment charge reflected on higher profit before tax as it improved by 2.56% to ₦38.87 billion in H1'19 (vs. ₦38.88 billion in H1'18). The bank made a higher provision of ₦8.15 billion for tax in H1'19 (vs. ₦5.36 billion in H1'18) and as a result profit after tax fell by 5.38% to ₦31.72 billion in H1'19 (vs. ₦33.52 billion in H1'18). The 12-month trailing EPS increased by 7.01% to ₦1.61, from ₦1.38 recorded in the previous period. Based on the recent figure released by the company, we maintain a **BUY recommendation** on the company's shares at the current price of ₦5.15 as present forward estimate places the company share price at ₦7.76.

Fig. 1: Quarterly results highlights

	2Q2019	1Q2019	2Q2018	Q/q Δ	Y/y Δ
Net Int. Income (₦mn)	72,536	74,181	73,893	-2.22%	-1.84%
PBT (₦mn)	20,567	19,304	20,059	+6.54%	+2.53%
Net profit (₦mn)	15,925	15,792	18,751	+0.84%	-15.07%

Source: NSE, PAC Research

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Price:

- Current	₦5.15
- Target	₦7.76
<b>Recommendation:</b>	<b>BUY</b>

\* As at Wednesday August 7, 2019

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-35.22%/-52.02%
52-week range	₦10.00 - ₦5.10
30-day Average vol.	18,318,204
Shares Outstanding ('mn)	35,895.29
Market Cap. (₦bn)	184.86
EPS (₦) - 12months trailing	1.61
DPS (₦) - FY2018	0.26

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	H1'19	H1'18
Net Interest Margin	7.70%	7.10%
Net profit margin	10.78%	11.43%
Equity multiplier	10.11x	8.04
Cash/ total Assets	13.06%	11.17%

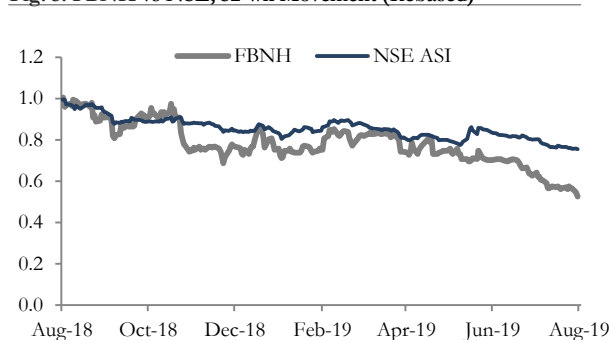
Source: NSE, PAC Research

Fig. 4: Valuation

	FY2017	FY2018	FY2019E	FY2020F
P/E	4.06x	3.09x	3.07x	2.67x
P/B	0.27x	0.35x	0.34x	0.33x
Div Yield (%)	4.85	5.05	5.05	7.77
Payout Ratio	19.73%	15.62%	15.50%	20.74%
P/S ratio	0.31	0.32	0.31	0.31
Rev per share	16.59	16.39	16.71	17.05
ROE	6.75%	11.26%	11.06%	12.34%
ROA	0.87%	1.07%	1.07%	1.20%

Source: NSE, PAC Research

Fig. 5: FBNH vs NSE, 52-wk Movement (Rebased)



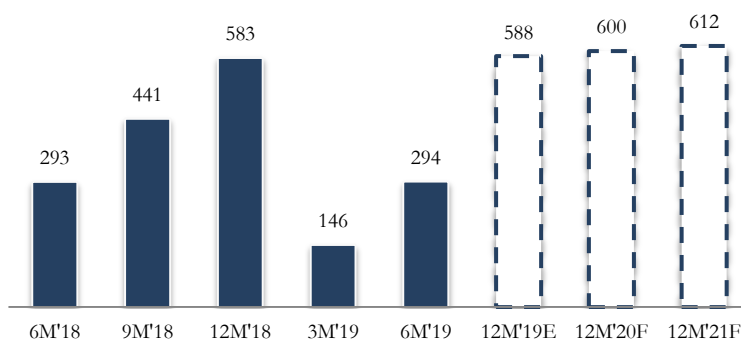
Source: Bloomberg, PAC Research

**Gross earnings improves by 0.31% YoY, supported by non-interest**

**revenue growth:** In the half year of 2019, First Bank of Nigeria recorded a marginal increase in the top-line, as gross earnings rose by 0.31% to ₦294.23 billion (vs. ₦293.34 billion reported in the half year of 2018). The improvement in the top-line can be attributed to impressive non-interest income generated by the bank during the period as it increased by 3.60% to ₦63.60 billion in H1'19 (vs. ₦61.30 billion recorded in H1'18). Improved fee & commission income and higher gains from financial instruments at fair value are the key drivers of non-interest income during the period under review. Although, a higher interest income from investment securities was recorded during the period, the bank recorded a significant lower interest income from loans & advances to customers and banks. As a result, the bank recorded a setback in total interest income as it declined by 1.61% to ₦221.70 billion in the six-month to June 2019 (vs. ₦225.40 billion in the six-month to June 2018).

*Improved fee & commission income and higher gains from financial instruments at fair value are the key drivers of non-interest income during the period...*

**Fig. 6: Gross Earnings – 6M'18-12M'21F (Billion NGN)**



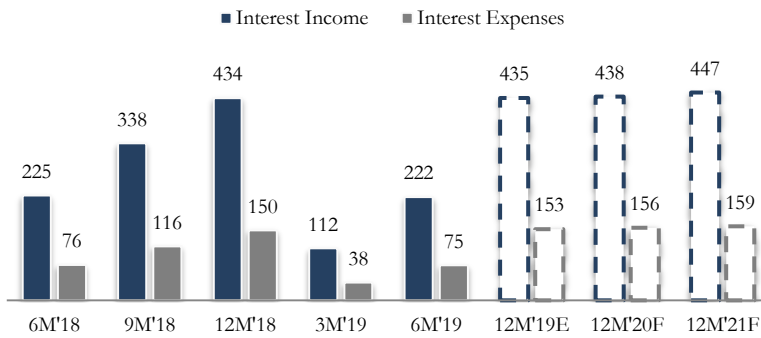
Source: NSE, PAC Research

**Interest income falls by 1.61%, due to contraction of the loan books:**

First Bank of Nigeria recorded an unimpressive figure for total interest income as it decreased by 1.61% to ₦221.78 billion in H1'19 (vs. ₦225.40 billion in H1'18). The declined total interest income can be attributed to the contraction of the loan books, reflected in reduced interest income from loans & advances to the customers. Interest income from loans and advances to customers declined by 9.83% to ₦122.07 billion in H1'19 (vs. ₦135.37 billion reported in H1'18). With improved investment securities and moderate yields, interest income from investment securities increased by 15.23% to ₦91.79 billion in H1'19 (vs. ₦79.66 billion reported in H1'18). However, the bank reported a lower figure for total interest expenses, driven by lower interest expenses on deposit from customers and reduced interest expenses on borrowing. Total interest expenses declined slightly by 0.93% to ₦75.06 billion in H1'19 (vs. ₦75.76 billion reported in H1'18). Consequently, net interest income dropped by 1.95% to ₦146.72 billion in H1'19 (vs. ₦149.64 billion in H1'18).

*The declined total interest income can be attributed to the contraction of the loan books, reflected in reduced interest income from loans & advances to the customers*

Fig. 7: Int. Income and Int. Expenses: 6M'18-12M'21F (Billion NGN)



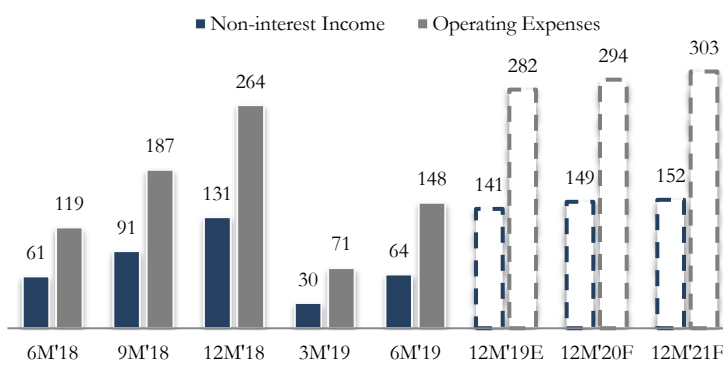
Source: NSE, PAC Research

**Non-interest income increases by 3.60%, driven by higher electronic banking revenue:** During the six-month to June 2019, the bank reported an impressive figure for non-interest income, which increased by 3.60% to ₦63.60 billion (vs. ₦61.30 billion recorded in the six-month to June 2018), mainly as a result of higher fee & commission income and gain from financial instruments at fair value. As a result of higher credit related fee, significant increased electronic banking revenue, improved fees from funds transfer & intermediation and higher revenue from account maintenance, total fee and commission income rose by 18.79% to ₦49.49 billion in H1'19 (vs. ₦41.66 billion in H1'18). The salient contributor to fee & commission income during the period is revenue from electronic banking, which increased by 46.32% to ₦21.83 billion (vs. ₦14.92 billion in H1'18). In addition, the bank recorded a gain of ₦3.56 billion on financial instruments at fair value in H1'19 (vs. a loss of ₦1.47 billion in H1'18).

However, the bank reported higher operating expenses of ₦148.29 billion in H1'19 (vs. ₦119.27 billion reported in H1'18), resulted in higher cost-to-income ratio of 70.50% (H1'18: 56.50%). The growth in total operating expenses can be largely attributed to higher personnel expenses, increased depreciation & amortisation, higher regulatory cost, improved expenses on advert & corporate promotions, operational and other losses, among others.

*The salient contributor to fee & commission income during the period is revenue from electronic banking, which increased by 46.32% to ₦21.83 billion...*

Fig. 8: Non-Int. Income and Operating Expenses: 6M'18-12M'21F (Billion NGN)

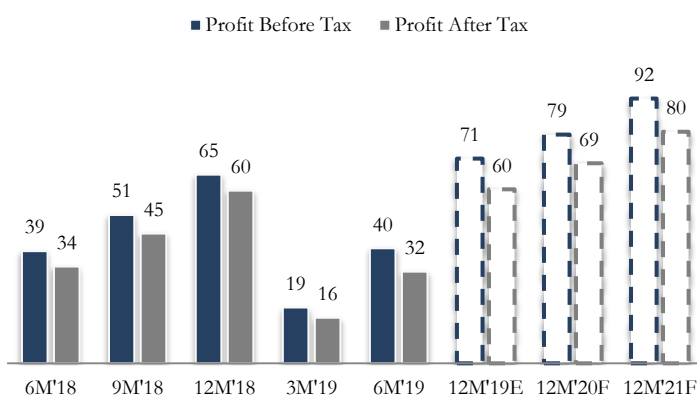


Source: NSE, PAC Research

**PBT grows by 2.56%, due to higher non-interest income and lower impairment charges:** Over the past few years, First Bank of Nigeria has been consistent in recording lower provisions for impairment charge and the half year of 2019 is not an exemption as the bank made a lower provision of ₦22.11 billion for impairment charge (vs. ₦52.81 billion in the half year of 2018). With lower provision for impairment charge, higher non-interest income and lower interest expenses during the period, profit before tax increased by 2.56% to ₦39.87 billion in H1'19 (vs. ₦38.88 billion in H1'18). However, the bank made a higher provision of ₦8.15 billion for tax in the half year of 2019 (vs. ₦5.36 billion in the half year of 2018), representing an increase of 52.24% year-on-year. Consequently, profit after tax fell by 5.38% to ₦31.72 billion in the half year of 2019 (vs. ₦33.52 billion in the half year of 2018). Impressively, 12-month trailing EPS increased by 17.01% to ₦1.61, from ₦1.38 recorded in the corresponding period of the previous year.

*With lower provision for impairment charge, higher non-interest income and lower interest expenses during the period, profit before tax increased by 2.56% to ₦39.87 billion...*

**Fig. 9: Profit before Tax and Profit after Tax – 6M'18-12M'21F (Billion NGN)**



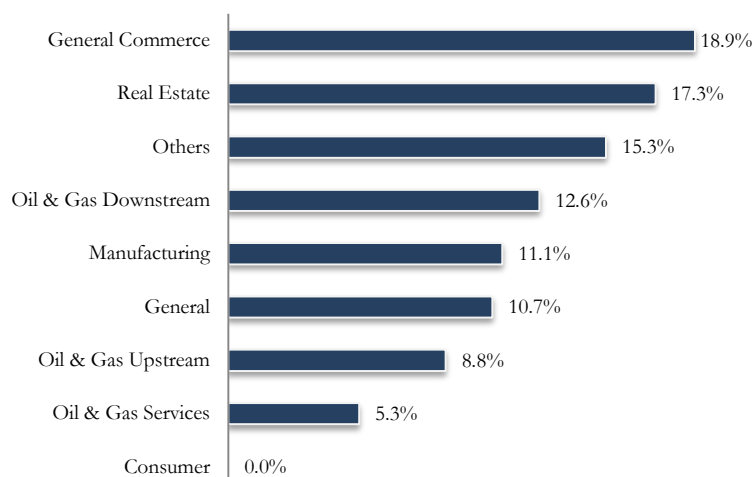
Source: NSE, PAC Research

**Movement towards complete balance sheet restructuring as NPL ratio trends downwards; expectation of unimpressive dividends in FY'19:**

In line with the commitment of the bank to address the asset quality challenges, exposure to the bank's largest NPL - Atlantic Energy - was written off, translated to a sharp fall in NPL ratio of the bank to 14.50% in H1'19, from 20.80% recorded in H1'18. The sharp decline in NPL ratio is in line with the target of the bank to achieve single digit NPL ratio by the 2019 year end. Of the NPL exposure by sector in the half year of 2019, Oil & Gas Upstream remains the largest exposure (18.90%), closely followed by Real Estate (17.30%). In addition, capital adequacy ratio and liquidity ratio are above the regulatory requirement of 15% and 30% respectively. In the review period, capital adequacy ratio closed at 15.60%, relative to 18.1% in the corresponding period of the previous year while liquidity ratio closed at 40.30% in the period, compared with 18.10% in the half year of 2018.

*...the bank's largest NPL - Atlantic Energy - was written off, translating to a sharp fall in NPL ratio of the bank to 14.50% in H1'19, from 20.80%...*

Fig. 10: NPL Exposure by Sector – H1'19



Source: FBNH, PAC Research

First Bank of Nigeria maintained a robust balance sheet position in the half year of 2019, reflected in improved total assets. Even with lower loans and advances, total assets increased by 6.85% to ₦5.67 trillion in H1'19 (vs. ₦5.31 trillion in H1'18). Higher deferred tax assets, intangible assets and improved investment securities contributed to improved total asset during the period. However, the bank recorded high figure for total liabilities in the half year of 2019 as it increased by 9.97% to ₦5.11 trillion in H1'19 (vs. ₦4.65 trillion in H1'18), mainly as a result of higher deposits from the customers during the period. Consequently, the net assets fell by 15.04% to ₦560.92 billion (vs. ₦660.20 billion in H1'18) and this translated to a net asset per share of ₦15.63 in H1'19, relative to ₦18.38 billion in the corresponding period of the previous year. Even, with improved NPL and 12-month trailing earnings per share, we do not expect a significant dividend payment in the full year of 2019 as the bank still maintain double digit NPL ratio. However, we assume improved dividends payment in the medium to long term as we expect lower impairment charge for credit losses.

Fig. 11: Total Liabilities Vs Net Asset in H1'19

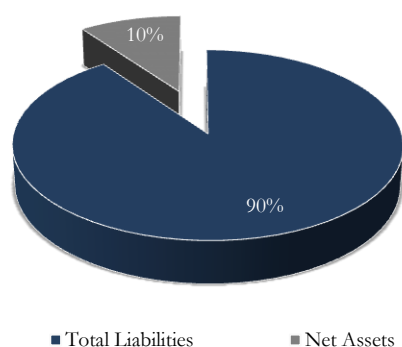
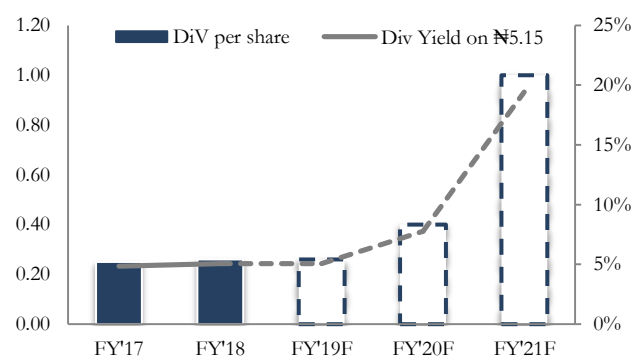


Fig. 12: Dividend Per Share and Dividend Yield (FY'17-FY'21F)



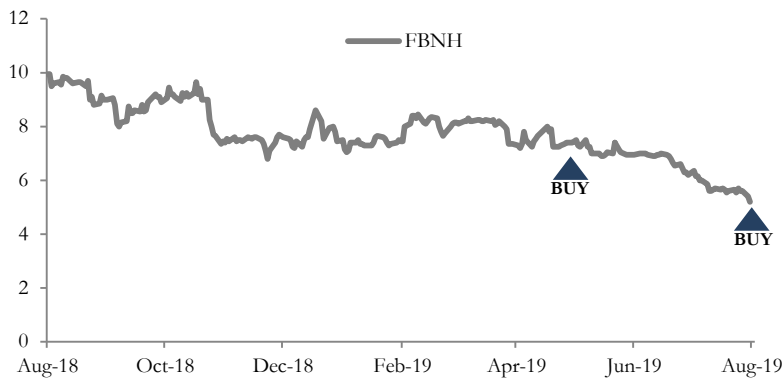
Source: NSE, PAC Research

## Valuation

Our valuation puts the target price of the stock at ₦7.76, representing an increase of 50.63% from the current price of ₦5.15. In arriving at the target price, we employed Dividend Discount Model. Consequently, we maintain a **BUY** recommendation on the stock of the company. Our valuation and forecasts considered several factors (both quantitative and qualitative) among which are; the previous financial reports of the company, the current figures released by the company, the performance of the bank in the banking industry and the bank's plan to reduce impairment charges.

*Our valuation puts the target price of the stock at N7.76, representing an increase of 50.63% from the current price of N5.15.*

**Fig. 13: Share Price History (Naira)**



Source: NSE, PAC Research

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**Fig. 14: Statement of Profit or Loss, N'mn**

	2017	2018	2019E	2020F
Gross Earnings	595,446	583,477	588,145	599,908
Change		-2.01%	0.80%	2.00%
Interest and Similar Income	469,586	434,410	434,933	437,933
Change		-7.49%	0.12%	0.69%
Interest and Similar Expenses	-138,064	-150,242	-152,918	-155,976
Change		8.82%	1.78%	2.00%
Net Interest Income	331,522	284,168	282,015	281,957
Change		-14.28%	-0.76%	-0.02%
Impairment Charge for credit losses	-150,424	-86,911	-49,992	-35,994
Change		-42.22%	-42.48%	-28.00%
Net Fees and Commission Income	62,336	75,394	81,164	86,387
Change		20.95%	7.65%	6.43%
Net gains/losses on Inv Sec	2,610	5,733	4,117	4,199
Change		119.66%	-28.19%	2.00%
Personnel expenses	-85,678	-93,395	-97,044	-101,984
Change		9.01%	3.91%	5.09%
Profit Before Taxation	54,522	65,288	70,854	79,168
Change		19.75%	8.53%	11.73%
Taxation	-9,040	-5,544	-10,628	-9,928
Change		-38.67%	91.70%	-6.59%
Profit After Taxation	45,482	59,744	60,226	69,240
Change		31.36%	0.81%	14.97%

**Fig. 15: Statement of Fin. Position, N'mn**

	2017	2018	2019E	2020F
Cash and cash equivalents	641,881	653,335	664,604	677,896
Loans and advances	2,726,152	2,547,248	2,529,023	2,579,603
Financial assets held for trading	83,713	109,162	123,510	131,980
Investment securities	1,248,608	1,663,821	1,823,249	1,859,714
Other assets	132,731	112,362	122,158	124,601
Assets pledged as collateral	208,925	309,051	217,614	221,966
Loans and advances to banks	742,929	863,435	911,624	929,857
Loans and adv. to customers	2,001,223	1,683,813	2,029,100	2,069,682
Property and equipment	88,263	91,515	89,574	91,366
Investments in associates	1,357	625	647	660
Total Assets	5,236,537	5,568,316	5,652,425	5,771,472
Deposits from banks	665,366	749,315	764,588	779,880
Deposits from customers	3,143,338	3,486,691	3,528,869	3,599,446
Other liabilities	266,198	373,345	382,294	389,940
Deferred tax liabilities	606	266	294	300
Liab. on insurance contracts	21,734	34,192	34,995	35,695
Borrowings	420,919	338,214	335,243	341,947
Total Liabilities	4,562,818	5,037,669	5,108,097	5,210,258
Net Assets	673,719	530,647	544,328	561,214
Total equity and liabilities	5,236,537	5,568,316	5,652,425	5,771,472

**Fig. 16: Profitability Ratio**

	2017	2018	2019E	2020F
Return on Equity	6.75%	11.26%	11.06%	12.34%
Return on Assets	0.87%	1.07%	1.07%	1.20%
Net interest income to Revenue	55.68%	48.70%	47.95%	47.00%
PBT margin	9.16%	11.19%	12.05%	13.20%
Net Profit Margin	7.64%	10.24%	10.24%	11.54%
ROCE	1.40%	1.45%	1.55%	1.70%

**Fig. 17: Asset Utilisation**

	2017	2018	2019E	2020F
Cash/Revenue	107.80%	111.97%	113.00%	113.00%
Revenue to total assets (x)	11.37%	10.48%	10.41%	10.39%
Interest Income / Total Assets	8.97%	7.80%	7.69%	7.59%
Loan Loss Exp./Net Int. Income	45.37%	30.58%	17.73%	12.77%
Loan Loss Exp./After Tax Profit	330.73%	145.47%	83.01%	51.98%
fixed asset turnover	14.82%	4.38%	4.50%	4.50%

**Fig. 18: Liquidity Ratios**

	2017	2018	2019E	2020F
Current ratio	1.15	1.11	1.11	1.11
Cash ratio	0.14	0.13	0.13	0.13
Interest Coverage ratio	0.39	0.43	0.46	0.51
Liquid Assets/Total Deposit	0.17	0.15	0.15	0.15
Loans & Advances/Total Deposit	0.72	0.60	0.59	0.59
Liquid Assets/Total Assets	0.12	0.12	0.12	0.12
Debt/net income	9.25	5.66	5.57	4.94
Debt to asset	0.08	0.06	0.06	0.06
Debt to equity	0.62	0.64	0.62	0.61
Total Liabilities / Total Asset	0.87	0.90	0.90	0.90
Total liabilities/equities	6.77	9.49	9.38	9.28

**Fig. 19: Shareholders' Investment Ratios**

	2017	2018	2019E	2020F
Earnings per share	1.27	1.66	1.68	1.93
DiV per share	0.25	0.26	0.26	0.40
NAVPS	18.77	14.78	15.16	15.63
Earnings yield	24.60%	32.32%	32.58%	37.46%

**Fig. 20: Capital Adequacy Ratios**

	2017	2018	2019E	2020F
Loans and Advances/Equity	4.05	4.80	4.65	4.60
Equity/Total Assets	0.13	0.10	0.10	0.10
Loan Loss Expense/ Equity	0.22	0.16	0.09	0.06

Source: Company's Annual Reports, PAC Research

**Equity research methodology employed in this report**

Views documented in this equity research report stem from conclusions reached through the use of multiple valuation methodologies, industry-wide knowledge, company specific information and our near to medium term expectations of industry and company performance, as well as market outlook. Our forecasts are based on a combination of top down and bottom up analysis, alongside historical trends in industry and company financials. Where appropriate, we factored in available forecasts and business direction provided by company management.

Our recommendation tends towards value investing. Therefore, our investment rank gauge—a customized scale we use to judge how well a firm under coverage has performed—is determined using major value parameters as well as relevant ratios and multiples computed with figures from the company's most recent financials.

The variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profit margins, growth, economic viability, gearing, relative valuation ratios, capital structure and management performance. Our investment recommendation is underpinned by the upside or downside potential of a stock under coverage. This potential is estimated by comparing the stock's current market price to its price target and fair value, on a percentage increase or decrease basis as summarized below:

Deviation from current price	Recommendation
>30%	STRONG BUY
10% to < 30%	BUY
-10% to < 10%	HOLD
<-10%	SELL



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