

Riding on First Quarter Tailwinds

Pandemic takes a toll on Second Quarter Earnings

In its recently released H1:2020 results, FBN Holdings Plc. (**FBNH**) sustained its earnings momentum from the first quarter, albeit as we expected, growth was at a much slower pace. This was off the back of a weak second quarter scorecard, which portrayed the impact of the pandemic on its business. Gross earnings growth slowed to 5.82% YoY (from 14.50% YoY in the first quarter), fueled largely by a QoQ decline (-37.28%) in non-interest income and more weakness in interest income (-2.28% QoQ). The dip in interest income is unsurprising given the current yield backdrop, triggering further depression in the company's asset yield to 10.80% (vs. 11.40% in H1:2019). In the same vein, non-interest earnings in the second quarter were impacted by a foreign exchange loss of NGN6.22bn (-336.19% QoQ) and fair value losses (-112.38% QoQ) on financial assets, which halved overall non-interest income growth to 40.41% YoY (from 83.15% in Q1:2020). Notwithstanding, we like the sustained growth momentum in its fees and commission income (+13.70% YoY), which was underpinned by improved e-transaction volumes and higher letters of credit transactions. Also, trading income (+601.33% YoY) benefitted immensely from the volatility in asset prices during the first half of the year. **Our outlook for gross earnings growth in 2020 remains unchanged, albeit we acknowledge that the gradual recovery of the business environment offers a positive boost to earnings in the second half.**

Profit from Sale of Insurance Business Amplifies Bottomline Performance

The bank maintained its cost optimization strategies in the second quarter, as we observed improvements across most of its cost centers. Interest expense fell by 29.48% QoQ, slowing the YoY growth to 1.44% (from 17.91% YoY in Q1:2020). This moved in line with our expectation, given the current low interest rate regime, which was further enhanced by the 100bps reduction in the MPR in May. Thus, we saw cost of funds fall to 2.80% (vs. 3.2% in H1:2019). However, this was insufficient to prevent a 70bps YoY contraction in net interest margin to 6.80%. Similarly, operating expenses remained flat (+0.90% YoY) at NGN139.17bn, with Cost to Income ratio (CIR) falling to 65.80% (from 70.30% in H1:2019). We observed an increase in Cost of risk by 90bps to 3.10% YoY, which is attributed to the weakness in the general economy, along with the impact of FX translation on foreign currency loans. Nevertheless, net profit from operations grew by 23.84% YoY, while the profit from sale of its Insurance subsidiary (+NGN11.26bn) further bolstered net profit growth for the period to 56.33% YoY.

LDR Non-compliance Brings Regulatory Backlash

The company grew its balance sheet significantly in the first half by 14.94% Ytd to NGN7.13trn, which was funded by increased customer deposits (+8.79% Ytd) and bank deposits (+38.61% Ytd). However, we observed that more of its funds (totaling NGN797.03bn) were sterilized into mandatory reserve deposits during the first half, as the bank failed to meet minimum LDR requirements. By our estimates, its LDR dipped by 48bps Ytd to 45.60%, which is well below the required minimum. **Given the bank's pragmatic stance towards loan growth, we expect LDR to remain around current levels in the second half.** We like the sustained downtrend in its NPL ratio to 8.80% (from 9.90% in 2019FY), despite the weak macroeconomic environment, while the improvement in its Capital Adequacy Ratio to 16.50% (from 15.50% in 2019FY) provides further comfort.

Recommendation

We upgrade our expected EPS to **NGN2.43 (prev. NGN2.00)**, following the completion of the divestment, and maintain our target PE of **2.87x**, which yields a December 2020 target price of **NGN6.97**. This indicates an upside potential of **38.10%**, hence we rate the ticker a **BUY**.

Company	FBNH
Valuation	
Trailing EPS	2.55
BVPS	19.62
P/E	1.98x
P/BV	0.26x
Target PE	2.87x
Dec-2020 Exp. EPS	2.43
Dec 2020 Target price	6.97
Current Price	5.05
Up/Downside Potential	+38.10%
Ratings	BUY
Key metrics	
ROE	14.50%
ROA	1.50%
Net margin	14.22%
Leverage	10.13x
Share/Share Price Statistics	
Yr High	7.70
Yr Low	3.70
YTD return	-17.89%
Beta	1.68
Adjusted Beta	1.45
52-Week Avg. Volume	27,173,410
Shares outstanding	35.90bn
Market cap [NGN]	177.68bn
Financial year end	December
Most Recent Period (MRP)	H1:2020

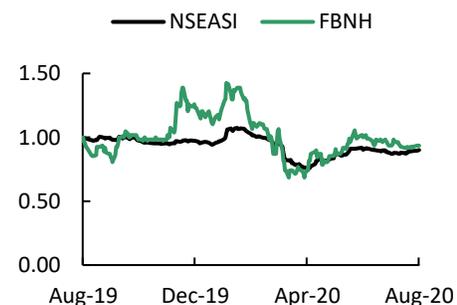


Chart 1: Sensitivity Analysis

Sensitivity Analysis of Dec-2020 Target Price to key model inputs						Min	5.36
						Max	8.69
						EPS	
		2.02	2.23	2.43	2.63	2.83	
Target PE	2.67x	5.39	5.95	6.49	7.02	7.56	
	2.77x	5.60	6.18	6.73	7.29	7.84	
	2.87x	5.80	6.40	6.97	7.55	8.12	
	2.97x	6.00	6.62	7.22	7.81	8.41	
	3.07x	6.20	6.85	7.46	8.07	8.69	

Financial Highlights (NGN billion) FBN HOLDINGS PLC H1:2020 Result

<i>Profit & Loss Account</i>	H1:2020	H1:2019	y/y Growth
Gross Earnings	296.55	280.24	5.82%
Interest Income	207.42	216.76	-4.31%
Interest Expense	76.14	75.06	1.44%
Loan Loss Expense	30.65	22.10	38.65%
Net Interest income after impairment charges	100.62	119.59	-15.86%
Non-Interest Income	89.13	63.48	40.41%
Operating Income	180.73	174.17	3.77%
OPEX	139.17	137.94	0.90%
PBT	41.42	36.25	14.26%
PAT	49.46	31.64	56.33%
<i>Balance Sheet</i>	H1:2020	2019FY	
Cash and short-term funds	1,806.32	1,025.33	76.17%
Loans and Advances to customers	1,994.28	1,852.41	7.66%
Investment Securities (incl. pledged assets)	1,939.10	2,162.11	-10.31%
Property and Equipment	112.06	112.94	-0.78%
Other Assets	1,278.47	1,050.74	21.67%
Total Assets	7,130.22	6,203.53	14.94%
Deposits from customers	4,373.22	4,019.84	8.79%
Financial Liabilities	244.96	250.60	-2.25%
Other Liabilities	1,807.95	1,271.97	42.14%
Total Liabilities	6,426.13	5,542.40	15.94%
Shareholders' fund	704.10	661.13	6.50%

Contact Information

Brokerage and Retail Services

topeoludimu@meristemng.com (+234 905 569 0627)
abisoyeoludipe@meristemng.com (+234 708 000 7861)
contact@meristemng.com

Investment Banking/Corporate Finance

seunlijofi@meristemng.com (+234 808 536 5766)

Wealth Management

damilolahassan@meristemng.com (+234 803 613 9123)
www.meristemwealth.com
Tel:+234 01 738 9948

Registrars

muboolasoko@meristemregistrars.com (+234 803 324 7996)
martinaosague@meristemregistrars.com (+234 802 303 1783)
www.meristemregistrars.com
Tel: +23401-280 9250

Group Business Development

saheedbashir@meristemng.com (+234 802 454 6575)
ifeomaogalue@meristemng.com (+234 802 3942967)

Client Services

blessingogwuche@meristemng.com (+234 706 896 5173)

Investment Research

ahmedjinad@meristemng.com (+234 809 183 9487)
research@meristemng.com

Corporate websites: www.meristemng.com www.meristemwealth.com www.meristemregistrars.com

Meristem Research can also be accessed on the following platforms:

Meristem Research portal: meristem.com.ng/rhub

Bloomberg: MERI <GO>

Capital IQ: www.capitaliq.com

ISI Emerging Markets: www.securities.com/ch.html?pc=NG

Reuters: www.thomsonreuters.com

FactSet: www.factset.com

Analyst's Certification and Disclaimer

This research report has been prepared by the research analyst(s), whose name(s) appear(s) on the cover of this report. Each research analyst hereby certifies, with respect to each security or issuer covers in this research that:

- (1) all of the views expressed in this report accurately reflect his or her personal views about any and all of the subject securities or issuers (the Issuer); and
- (2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. Research analysts' compensation is determined based upon activities and services intended to benefit the investor clients of Meristem Securities Limited (the Firm). Like all of the Firm's employees, research analysts receive compensation that is impacted by overall Firm profitability, which includes revenues from other business units within the Firm.
- (3) each research analyst and/or persons connected with any research analyst may have interacted with sales and trading personnel, or similar, for the purpose of gathering, synthesizing and interpreting non-material non-public or material public market information.

As at the date of this report, any ratings, forecasts, estimates, opinions or views herein constitute a judgment, and are not connected to research analysts' compensations. In the case of non-currency of the date of this report, the views and contents may not reflect the research analysts' current thinking. This document has been produced independently of the Issuer. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the ratings, forecasts, estimates, opinions and views contained herein are fair and reasonable, neither the research analysts, the Issuer, nor any of its directors, officers or employees, shall be in any way responsible for the contents hereof, and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith.

Analysts' Compensation: The equity research analysts responsible for the preparation of this report receive compensation based upon various factors, including the quality and accuracy of research, client feedback, competitive factors, and overall firm revenues, which include revenues from, among other business units, Investment Banking.

Investment Ratings

Fair Value Estimate

We estimate stock's fair value by computing a weighted average of projected prices derived from discounted cash flow and relative valuation methodologies. The choice of relative valuation methodology (ies) usually depends on the firm's peculiar business model and what in the opinion of our analyst is considered as a key driver of the stock's value from a firm specific as well as an industry perspective. However, we attach the most weight to discounted cash flow valuation methodology.

Target Price Estimate

While we believe that the fair value is underpinned by the future benefits stream and growth outlooks, which are primary drivers of value, the market might not align to the fair value estimate within the estimated investment horizon. Thus, we do not derive our target price from the fair value but from a trading perspective using the year projected earnings or book value and the respective target multiples. Notwithstanding, we are of the opinion that the variance between the two should not be too significant.

Ratings Specification

- BUY:** Target Price of the stock is above the current market price by at least **10 percent**
- HOLD:** Target Price of the stock ranges between **-10 percent and 10 percent** from the current market price.
- SELL:** Target Price of the stock is more than **10 percent** below the current market price.

Definitions

Price Targets: Price targets reflect in part the analyst's estimates for the company's earnings. The achievement of any price target may be impeded by general market and macroeconomic trends, and by other risks related to the company or market and may not occur if the company's earnings fall short of estimates.

Asset allocation: The recommended weighting for equities, cash and fixed income instrument is based on a number of metrics and does not relate to a particular size change in one variable.

Movements in Price Target

Company Name: FBN Holdings Plc.

Date	Price (N)	Previous Target Price(N)	New Target Price (N)	Previous Recommendation	New Recommendation
16-May-2020	4.95	8.12	5.74	BUY	BUY
05-Aug-2020	5.05	5.74	6.97	BUY	BUY

Company disclosures

Meristem or the analyst(s) responsible for the coverage may have financial or beneficial interest in securities or related investments discussed in this report, which could, unintentionally, affect the objectivity of this report. Material interests, which Meristem or the analyst(s) have with companies or in securities discussed in this report, are disclosed below:

Company	Disclosure
FBN Holdings Plc	

- a. The analyst(s) hold(s) personal positions (directly or indirectly) in a class of the common equity securities of the company.
- b. The analyst responsible for this report, as indicated on the front page, is a board member, officer or director of the company
- c. Meristem beneficially owns 1% or more of the equity securities of the company
- d. Meristem has been the lead manager or co-lead manager of any publicly disclosed offer of securities of the company over the past 12 months.
- e. Meristem beneficially holds a major interest in the debt of the company
- f. Meristem has received compensation for investment banking activities from the company within the last 12 months
- g. Meristem intends to seek, or anticipates receipt of compensation for investment banking services from the company in the next 3 months
- h. The content of this research report has been communicated with the company, following which this research has been materially amended before its distribution
- i. The company is a client of the stock broking division of the Meristem group.
- j. The company is a client of the investment banking division of the Meristem group.
- k. Meristem is the registrar to the company.
- l. The company owns more than 5% of the issued share capital of Meristem
- m. Meristem has other financial or other material interest in the company.

Conflict of Interest

It is the policy of Meristem Securities Limited and its subsidiaries and affiliates (Individually and collectively referred to as “Meristem”) that research analysts may not be involved in activities that suggest that they are representing the interests of Meristem in a way likely to appear to be inconsistent with providing independent investment research. In addition, research analysts’ reporting lines are structured so as to avoid any conflict of interests.

For example, research analysts are not subject to the supervision or control of anyone in Meristem’s Investment Banking or Sales and trading departments. However, such sales and trading departments may trade, as principal, on the basis of the research analysts’ published research. Therefore, the proprietary interests of those Sales and Trading departments may conflict with your interests.

Important Disclosure

For U.S. persons only: This research report is a product of Meristem Securities, which is the employer of the research analysts who has prepared the research report. The research analysts preparing the research report are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analysts are not subject to supervision by a U.S. broker-dealer, and are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This report is intended for distribution by Meristem Securities only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a 6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor.

Legal entity disclosures

Meristem Securities Limited is a member of The Nigerian Stock Exchange and is authorized and regulated by the Securities and Exchange Commission to conduct investment banking and financial advisory business in Nigeria. However, the company through its subsidiaries carries out stock broking, wealth management, trustees and registrars businesses which are regulated by the SEC and ICMR.

Copyright 2020 Meristem Securities Limited. All rights reserved. This report or any portion hereof may not be reprinted, sold or redistributed without the written consent of Meristem Securities Limited.