



FIDELITYBK RIGHTS ISSUE NOTE

Meristem Research
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Analyst:
Matilda Adefalajo
matildaadefalajo@meristemng.com

Fidelity Bank Plc (**FIDELITYBK**) has recently come to the market to announce a rights issue and public offer, aiming to raise a total of up to NGN127.10 billion. This move is part of the bank's strategy to increase its share capital base in compliance with the revised minimum capital requirements for Nigerian commercial banks introduced by the Central Bank of Nigeria (CBN) on March 28, 2024. The rights issue and public offer are expected to support the bank's efforts to drive sustained growth and diversification of its earnings base.

Rights Issue Details

The rights issue will offer 3,200,000,000 ordinary shares of 50 kobo each at NGN9.25 per share. The ratio for the rights issue is 1 new ordinary share for every 10 ordinary shares held as of January 5, 2024. The acceptance and application lists for the rights issue opened on June 20, 2024, and closes on July 29, 2024.

Public Offer Details

The public offer will issue 10,000,000,000 ordinary shares of 50 kobo each at NGN9.75 per share. It is open to the general investing public and is expected to close on July 29, 2024.

Key Details of the Offer

Type	Rights Issue (Offered to existing shareholders as of January 5, 2024) Public Offer (Open to general investing public)
Number of Shares	Rights Issue: 3.20 billion ordinary shares of 50 kobo each Public Offer: 10.00 billion ordinary shares of 50 kobo each
Total Number of Shares on Offering	13.20 billion ordinary shares of 50 kobo each
Price	Rights Issue: NGN9.25 per share Public Offer: NGN9.75 per share
Rights Issue Ratio	1 new ordinary share for every 10 ordinary shares held as of January 5, 2024
Qualification Date	January 5, 2024
Opening Date	June 20, 2024
Closing Date	July 29, 2024
Use of Proceeds	The proceeds from the issue are expected to be utilised for the following: <ul style="list-style-type: none"> • Business and regional expansion (70% of proceeds) <ul style="list-style-type: none"> ➢ Lending to the Retail Business Segment (10% of proceeds) ➢ Lending to the SME Segment (15% of proceeds) ➢ Lending to the Corporate & Commercial Segment (42.50% of proceeds) ➢ Investment in regional expansion (2.50% of proceeds) • Investment in IT infrastructure (12% of proceeds) <ul style="list-style-type: none"> ➢ Investment in Cyber Security Capabilities (9.50% of proceeds) ➢ Software licenses & hardware (8.00% of proceeds)

	<ul style="list-style-type: none"> ➤ Additional investment network infrastructure (2.50% of proceeds) • Investment in product distribution channels (10% of proceeds) <ul style="list-style-type: none"> ➤ Renovation of branches (7.00% of proceeds) ➤ Investment in ATMs (1.00% of proceeds) ➤ Investment in POSs (2.00% of proceeds)
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Company Overview and Strategy

FIDELITYBK boasts over 5 million customers with over 250 business offices, focusing on implementing technology-based retail banking to capture customers through digital-enabled products. Over 40% of its customers have been onboarded on its digital products, resulting in exponential growth in savings deposits over the last five years. In 2023, Fidelity Bank Nigeria concluded the acquisition of Union Bank UK (now FidBank UK Limited), expected to support the bank's expansion strategy and boost overall income growth. The bank operates through Retail Banking, Corporate Banking, and Investment Banking segments, offering various banking products and services to corporate and individual customers in Nigeria, including current, savings, and fixed deposit accounts, asset leasing, personal loans and mortgages, and treasury bills, fixed income securities, and foreign exchange and derivatives.

Future Plans

Fidelity Bank's future plans focus on enhancing distribution and funding capabilities by expanding its e-channels network, increasing its agency banking network, partnering with FinTech companies, and forming strategic funding alliances. The bank aims to deepen its presence in the retail and SME segments and strengthen its market share in niche corporate sectors like IT and Telecoms. In the medium term, Fidelity Bank will leverage its corporate clients' value chains to maximize benefits for its commercial, SME, and private banking sectors. The bank also plans to fully utilize technology investments, diversify its earnings through digitization, and consolidate its leadership in corporate, SME, retail, and e-Banking. Long-term goals include expanding distribution in target markets, delivering exceptional customer service with technological support, becoming a market leader in all products, and developing a robust consumer finance offering via a wider electronic platform.

Strategic Cost Management Amid High Yield Environment

FIDELITYBK recorded an increase in its gross earnings by +64.91% YoY to NGN555.83bn in 2023FY (vs NGN337.05bn in 2022) comprising of contributions from interest and non-interest income. The rise in interest income reflects the steady rise in asset yield (+131bps to 13.54% in 2023FY). This was complemented by an increase in revenue from loans and advances to customers (+46.11% YoY), credited to the higher lending rate and expanded loan book. Also, non-interest income was boosted by the increase in fees and commission to NGN49.60bn (vs NGN34.42bn in 2022FY), coupled with contributions from other operating income of NGN46.70bn (vs NGN7.05bn in the prior year) driven by

an increase in net foreign exchange gain, which grew to NGN44.09bn (vs NGN2.68bn in 2022FY). The current yield environment also impacted gains from financial instruments, resulting in a positive value of NGN24.78bn in 2023FY from a negative figure of **NGN1.56bn** in 2022FY.

Despite the high yield environment, the bank recorded a 20bps drop in average funding cost to 4.41% in 2023FY. This improvement was driven by an increased deployment of its current and savings accounts, which comprised 97.37% of total deposits, up from 83.62% in 2022. However, total interest expenses rose by 27.50% to NGN182.17bn (vs 142.88bn in 2022FY). The bank also recorded a significant increase in its credit loss expense to NGN67.44bn (vs NGN5.44bn in 2022FY) driven by significant credit loss expense in stage two and three loans to customers. Additionally, the twin impact of fuel subsidy removal and devaluation of the naira led to increased maintenance and repairs cost. The group also recorded higher expense on salaries (+92.71% YoY), regulatory cost (+35.07% YoY), repairs and maintenance (+54.07% YoY) and other expenses (+285.88% YoY). Notwithstanding, the cost-to-income ratio dipped to 50.42% from 67.14% in 2022FY due to a combination of higher operating income and a moderation in operating expenses. Overall, profit after tax grew by 112.86% to NGN99.45bn from NGN46.72bn in 2022FY with contributions from net interest income, non-interest income and other operating income.

	2018	2019	2020	2021	2022	2023
Capital Adequacy Ratio	16.70%	18.30%	18.20%	20.12%	18.12%	16.24%
Non-Performing Loans	5.69%	3.28%	3.81%	2.90%	2.89%	3.51%
Return on Equity	11.59%	13.27%	10.50%	8.27%	15.58%	26.46%

Our expectation for continued growth in 2024 is expected to be influenced by sustained increase in asset yield, driven by several key factors: expanded lending activities, higher average lending rates, and enhanced yields on investment securities. This is expected to drive increases in the revenue-earning items. On the other hand, interest expenses will continue to mirror the inflationary and high interest environment. However, the growth in interest and non-interest income is expected to outpace the growth in interest expense and lead to an overall increase in the bank's bottom-line.

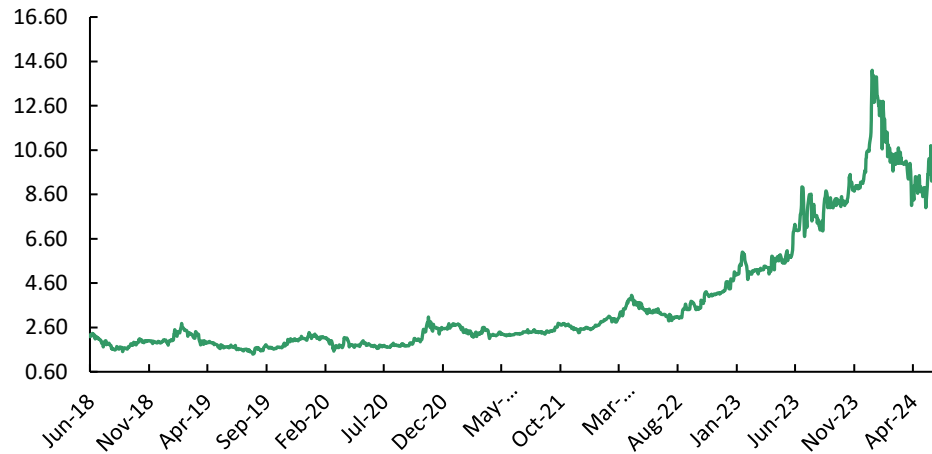
This move demonstrates the bank's proactive and strategic approach to managing its capital structure. It not only positions the bank to comply with the new regulations, but also signals its confidence in its growth prospects and ability to deploy the additional capital effectively.

Benefits of the Issue to Investors

The ratio of 1 new ordinary share for every 10 ordinary shares held as of January 5, 2024, means that for every 10 shares an investor holds, they will receive 1 new share. In the case of an individual investor holding 10,000 shares, they will receive 1,000 new shares (10,000 / 10 = 1,000). The rights issue price (NGN9.25) is lower than the prevailing market price of the stock. This presents an opportunity for existing shareholders to acquire additional shares at a potential discount.

Share Price Trajectory

Chart 1: Average Share price over a five-year period



Source: Bloomberg, Meristem Research

From a valuation perspective, we see room for further growth in the firm's value based on our projection for future cashflows. We utilise a blended approach comprising both income approach and relative valuation methodology. Thus, we have arrived at a valuation of NGN13.32. This presents a 44.03% upside to the rights issue target price and 34.57% to the current market price. On this basis we recommend a BUY for its public offer and advise interested existing investors to take up their rights and increase their shareholdings.

Valuation Summary

Metrics

Risk free rate	19.26%
Adjusted Beta	1.23%
Cost of equity	30.39%
Sustainable growth rate *Haircut	7.72%

Techniques and Weightings

Dividend Discounting Model (DDM)- 34%	NGN2.56
Equity Discounted Cashflow Approach (FCFE)- 33%	NGN25.61
Relative valuation – 33%	NGN12.21
Equity Value per share	NGN13.32
Present Share Price	NGN9.90
Rights Issue Price	NGN9.25
Upside Potential	NGN44.03

The firm's dividend history also depicts a dividend-paying culture that would be attractive to investors interested in dividend-targeted investment portfolios.

Dividend History	Interim	Final	Total DPS	Dividend Payout ratio	Dividend Yield
2017	-	0.11	0.11	27.99%	4.37%
2018	-	0.11	0.11	21.69%	5.53%
2019	-	0.20	0.20	31.81%	9.80%
2020	-	0.22	0.22	37.82%	9.17%
2021	-	0.35	0.35	68.49%	8.64%
2022	0.10	0.40	0.50	48.38%	8.50%
2023	0.25	0.60	0.85	38.64%	9.28%

Favourable Offer Term

The terms of Fidelity Bank's rights issue are also attractive for investors. The issue price of NGN9.25 per share represents a discount to the current market price (NGN9.90 as of 21st June 2024), providing an opportunity for existing shareholders to increase their stake in the bank at a favourable valuation.

Investors should consider taking up their Rights for several reasons. By participating, they maintain their proportional ownership in the company, avoid dilution of their stake, and acquire shares at a discounted price. This allows them to participate in the company's future growth, potentially benefiting from increased value appreciation and dividends.

Contact Information

Brokerage and Retail Services

topeoludimu@meristemng.com (+234 905 569 0627)
adaezeonyemachi@meristemng.com (+234 808 369 0213)
contact@meristemng.com

Investment Banking/Corporate Finance

rasakisalawu@meristemng.com (+234 806 022 9889)
davidadu@meristemng.com (+234 810 940 4836)

Wealth Management

funmilolaadekola-daramola@meristemng.com (+234 805 498 4522)
crmwealth@meristemng.com
Tel : +234 01 738 9948

Registrars

nkechiyluokoye@meristemregistrars.com (+234 803 526 1801)
www.meristemregistrars.com
Tel: +23401-280 9250

Trust Services

damilolahassan@meristemng.com (+234 803 613 9123)
trustees@meristemng.com

Group Business Development

sulaimanadedokun@mersitemng.com (+234 803 301 3331)
ifeomaanyanwu@meristemng.com (+234 802 394 2967)
info@meristemng.com

Client Services

adefemitaiwo@meristemng.com (+234 803 694 3034)
car@meristemng.com

Investment Research

praiseihansekhien@meristemng.com (+234 817 007 1512)
research@meristemng.com

Finance

olasokomubo@meristemfinance.com (+234 803 324 7996)
matthewawotundun@meristemfinance.com (+234 802 390 6249)

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

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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.

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- 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.

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