

NCB Financial Group Limited

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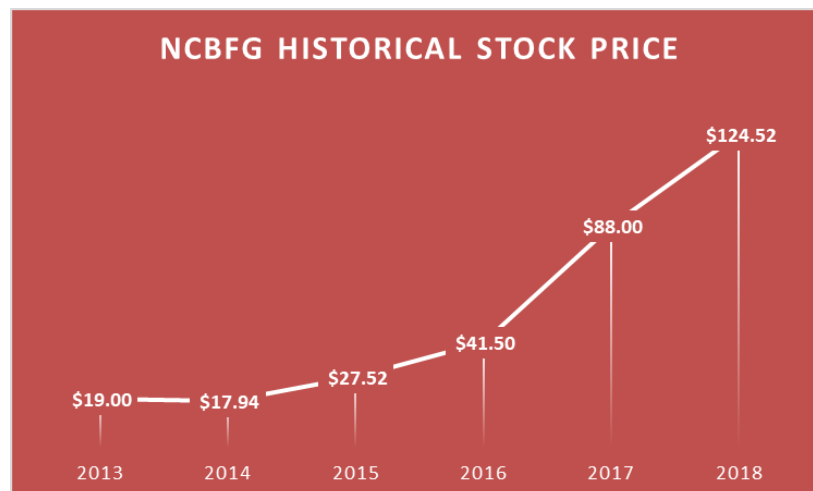
Executive Summary

NCB Financial Group Limited (NCBFG) is the most profitable listed entity in Jamaica, reporting record FY 2018 profits attributable to NCBFG shareholders of \$27.96 billion. NCBFG is incorporated and domiciled in Jamaica, it is 53.02% owned by AIC (Barbados) Limited. The ultimate parent company of AIC is Portland Holdings Inc., incorporated in Canada. Portland Holdings Inc. is controlled by Hon. Michael A. Lee-Chin, OJ, and Chairman of NCBFG. NCBFG currently has operations in Jamaica, Cayman Islands, Trinidad and Tobago, Barbados and Bermuda and the United Kingdom.

The NCB Group has several subsidiaries including National Commercial Bank (NCBJ), NCB Capital Markets Limited, NCB Insurance Company Limited and Advantage General Insurance Company Limited. In May 2016 NCBFG acquired a 29.99% interest in Guardian Holdings Limited (GHL); also in Q4-2018 NCBFG reduced its stake in JMMB Group Limited from 26.30% to 20.01%. Furthermore, in Q1 2019 NCBFG eliminated its stake in JMMBGL in a \$9 billion transaction, and in the process realised gains of approximately \$3 billion. Additionally, in Q1 2018 NCBFG acquired a 50.1% stake in the Clarien Group Limited the parent of Bermuda based Clarien Bank Limited.

NCBFG is also the largest listed company by market capitalisation, which is currently \$362.98 billion, significantly more than the second placed Scotia Group Jamaica (SGJ) with a market cap of \$149.20 billion. As at the end of FY 2018, NCBFG has total assets of \$978.58 billion far exceeding Scotia Group's \$521.86 billion as at its year-end October 31, 2018.

NCBFG has seen significant share price appreciation beginning in calendar year 2015. Earnings have increased over the period; however, the stock price increase has outpaced resulting in multiple expansion starting in 2015.



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Recent Developments

On December 18, 2018 NCBFG announced an update to its offer for GHL. NCBFG will now seek to acquire up to 62% of GHL at a price of US\$2.79 per share, representing an increase from the US\$2.65 per share for 51.85% of the outstanding shares of GHL made on November 16, 2018. NCBFG launched through its subsidiary NCB Global Holdings Limited a bid for 74.23 million GHL shares in a transaction valued at US\$ 207.10 million. On December 27, 2018 NCBFG sold the balance of its stake (20.01%) in JMMBGL and recorded a gain of approximately \$3 billion due to the sale which will be reflected in the first quarter of FY 2019.

Key Financial Data

	2014	2015	2016	2017	2018	CAGR
BVPS	33.25	35.91	41.89	47.12	52.83	12.27%
EPS	5.01	5.00	5.87	7.76	11.39	22.79%
Dividend Per Share	1.18	2.31	2.35	2.70	2.70	22.99%
Operating Income(\$B)	43.25	47.47	51.57	59.47	76.55	15.34%
Net Interest Income(\$B)	24.66	25.96	28.12	29.76	35.14	9.26%
Investment Gains(\$B)¹	2.59	3.75	4.73	7.73	15.61	56.65%
Staff Costs(\$B)	11.52	11.94	13.81	16.46	23.78	19.85%
Other Operating Expense	9.74	12.21	13.38	14.59	16.41	13.93%
Profits to NCBFG Holders	12.33	12.30	14.45	19.12	27.96	22.72%
Total Assets	499.35	523.82	607.67	693.72	978.58	18.32%
Loans	157.63	165.40	189.06	218.62	372.62	24.00%
Investment Securities	105.56	166.02	166.43	189.07	210.35	18.81%
Customer Deposits	202.16	227.85	273.97	288.46	484.85	24.44%
Other Borrowed Funds	11.99	8.60	12.06	38.65	65.56	52.91%
Equity	81.85	88.39	103.12	115.99	130.04	12.27%
Ratios						
P/E	3.58	5.50	7.07	11.21	10.93	
P/B	0.54	0.77	0.99	1.85	2.36	
Dividend Yield	6.58%	8.39%	5.66%	3.10%	2.17%	
Cost to Income	62.21%	62.34%	63.72%	63.20%	63.22%	
ROE	15.97%	14.45%	15.09%	17.44%	22.73%	
ROA	2.61%	2.40%	2.55%	2.94%	3.34%	
Dividend Payout Ratio	23.55%	46.20%	40.03%	34.79%	23.71%	
Share Price	17.94	27.52	41.50	87.02	124.52	

¹ Gain on foreign currency and Investment Activity

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Financial Overview

Total Operating Income (TOI) at NCBFG has increased at a CAGR of 15.34% for the period FY 2014 to FY 2018 (period under review), to a record of \$76.54 billion. **Net Interest income (NII) was the most significant contributor to FY 2018 TOI accounting for 45.92%.** The majority of NII is earned from loans and investment securities. **Gain on foreign currency and investment activities is the fastest growing revenue item, increasing at a CAGR of 56.65% for the period under review.** The major contributor to this revenue source is 'net gain on foreign currency and sale of debt securities' (GFD). Of note GFD increased by 102.06% or \$7.89 billion in FY 2018, to a record \$15.61 billion. Staff cost has remained a significant expense at NCBFG accounting for 47.22% of 2018 expenditures. Staff cost increased at a CAGR of 13.93% for the period under review with the majority of the increases occurring in FY 2018, as a result of the Clarien acquisition.

Total assets for NCBFG as at the end of FY 2018 stood at \$978.58 billion resulting in a CAGR of 18.32% for the period under review. The most significant assets for NCBFG include loans, investment securities (IS) and pledged assets (repo) which account for 38.08%, 21.50% and 18.24% respectively of total assets. Loans have increased at a CAGR of 24% for the period under review. In Q1 2018 loans surged by \$103.75 billion or 47.46% due in part to the acquisition of Clarien Bank. As at the end of FY 2018 total investment securities stood at \$385.80 billion, of which \$254.48 billion or 65.26% is in GOJ or GOJ guaranteed corporates. 'Other Borrowed Funds' in FY 2018 is primarily comprised of corporate notes of \$58.81 billion. The corporate notes are in USD/JMD and fixed/floating with the former attracting between 4.25% and 9.75% while the variable notes attract interest of 6-month WATBY plus 2.25% - 2.5% premium.

NCBFG's P/E ratio is coming from a low of 3.59x as at the end of FY 2014. P/E multiple expansion began in Q2 2015 (5.11x) and started to accelerate in Q1 2016 (7.84x). The initial 2015 P/E multiple expansion was in line with the strength seen in the stock market in calendar 2015 when the Main Market surged 97.36%. Meanwhile, P/B ratio was at a low in Q1 2015 of 0.52x, which indicates a highly conservative outlook by investors in the past. EPS has increased at a CAGR of 23% for the period under review, but NCBFG's share price has risen at a CAGR of 62% over the same period, which has resulted in P/E multiple expansion.

Forecast and Valuation

We used the projected FY 2019 EPS and BVPS and then applied the 1-year average P/E and P/B ratios to arrive at the price target of \$137.79 per share. Innate in our base case assumption is market sentiment remains at recent levels, leading to NCBFG maintaining average P/E and P/B multiple ratios over the past year. We see this as a reasonable premise given the improving economy and recent international rating upgrade by FITCH. Also of note NCBFG's average P/E multiple over the past year is in line with its peers which is 12.64x. NCBFG's P/B ratio averaged 2.20x over the past year which is above peers for the same period. However, we view this as plausible given NCBFG's ROE is

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considerably above peers in particular SGJ. Using the dividend discount model (DDM) we arrived at a price target of \$139.94 in line with our relative value price target.

Ticker	Market Cap	P/E	P/B	Div Yield	ROA	ROE
SGJ	174.25	13.63	1.51	3.48%	2.52%	11.71%
NCBFG	368.78	13.19	2.84	1.87%	3.34%	22.73%
JMMBGL	55.42	15.59	2.11	1.27%	1.31%	13.63%
SJ	156.19	13.15	2.13	0.98%	3.21%	17.12%

Outlook

We expect meaningful earnings growth from the increased stake in GHL. Also, the increased stake will give NCBFG majority control therefore, similar segments can be merged/eliminated leading to synergies for NCBFG. However, the impact of this could be limited because as of December 31, 2017 only 19% of GHL operations in Jamaica. The GHL acquisition will also give NCBFG a presence in the Dutch Caribbean which accounts for 26% of GHL's FY 2017 revenue. We expect the NCBFG acquisition of GHL to close by Q3 2019 and add incrementally to NCBFG earnings. Going forward into 2020 we anticipate synergies from the Clarien Bank and GHL acquisitions to be the key drivers of growth.

Key Risks to Our Price Target

Key risks to our price target include NCBFG being unable to meet our GFD expectation which is expected to be marginally below FY 2018 level. **GHL, while it has adequate reinsurance, could face a surge in expenses if a natural disaster were to hit its significant markets, such as Trinidad and Tobago, which accounts for 53% of FY 2017 revenue.**

Recommendation:

We recommend a **MARKETWEIGHT** rating on NCBFG at this point given that the stock currently trades at \$149.50² a 7.83% premium to our **base case price target of \$137.79**. **Our best case scenario price target uses an average of P/E and P/B multiple of 2 standard deviations above the last 1- year average applied to FY 2019 EPS and BVPS produces a price target of \$167.21**. Therefore the stock does have 12% upside to the top end of our forecast.

Source: <http://www.Jamstockex.com>, *JMMB Investment & Research, Bloomberg, Various Company Financial Statements.*

² At January 3, 2019

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APPENDIX**IMPORTANT DISCLOSURES**

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

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SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

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OVERWEIGHT/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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