

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 2019 profits attributable to its shareholders of \$29.58 billion. NCBFG is incorporated and domiciled in Jamaica, it is 52.10% owned by AIC (Barbados) Limited. The ultimate parent company of AIC is Portland Holdings Inc., which is domiciled in Canada. Portland Holdings Inc. is controlled by Hon. Michael A. Lee-Chin, OJ, who serves as Chairman of the NCBFG. The company currently has operations in Jamaica, the Cayman Islands, Trinidad & Tobago, Barbados, Bermuda and the United Kingdom, plus several other countries through its subsidiary Guardian Holdings Limited.

NCBFG has three direct subsidiaries, namely National Commercial Bank Jamaica (NCBJ), Clarien Bank Limited (Clarien) and NCB Global Holdings Limited (Holding company of Guardian Holdings Limited). In May 2016 NCBFG acquired a 29.99% interest in Guardian Holdings Limited (GHL). It subsequently increased its stake, in GHL to 62% on May 13, 2019 when it acquired a majority interest. Additionally, in Q1 FY 2018, NCBFG acquired a 50.1% stake in Clarien Group Limited, the parent of Bermuda based Clarien Bank Limited. Finally, on September 30, 2019 NCBFG finalized the sale of its 100% stake in Advantage General Insurance Company Limited. **NCBFG Total Assets has surged to \$1.61 trillion as at the end of FY 2019 due in part to the consolidation of Guardian Holdings Limited (GHL).**

For the period under review (FY 2015 to FY 2019) NCBFG profits attributable to shareholders has increased at a CAGR of 25.52% to record levels. Meanwhile, total assets has increased at a CAGR of 32.41% to a record \$1.61 trillion aided by mergers and acquisitions.

NCBFG has produced significant share price appreciation since 2015. However NCBFG is down approximately 40% from its closing high of \$220.75 on July 26, 2019.



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Recent Developments

For Q3 ended June 2020 NCBFG recorded a decline of \$1.10 billion or 5.66% in net operating income from its banking and investment segment. However, its insurance activities produced net operating income growth of \$5.21 billion or 154.68% to \$8.58 billion. This aided the company in producing operating profit growth of 36.50% or \$2.36 billion in Q3 FY 2020. However, profits attributable to shareholders was \$5.21 billion, a decrease of \$3.09 billion or 37.22%. This was partially due to Q3 FY 2019 earnings being supported by a one-off gain of \$2.3 billion.

Furthermore, NCBFG recently obtained approval to transfer 100% of (NCB Insurance Company Limited) NCBI's portfolio of insurance and annuities business to Guardian Life Limited (GLL), which will take effect on September 30, 2020. After the transfer NCBI will operate under a new company name and sell insurance products as an exclusive agent of GLL. NCBI will continue to provide pension fund administration and investment management services.

Key Financial Data

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	CAGR	Q3 2019	Q3 2020	% Change
BVPS	35.91	41.89	47.12	53.00	60.33	13.85%	55.85	62.11	11.21%
EPS	5.00	5.87	7.76	11.39	12.18	24.92%	8.46	6.16	-27.17%
Dividend Per Share	2.31	2.35	2.70	2.70	3.40	10.15%	2.50	1.90	-24.00%
Share Price	27.52	41.50	87.02	124.52	208.79	65.96%	189.52	136.43	-28.01%
JSE Main Market	96,324.59	164,482.25	262,729.14	358,320.11	516,042.91	52.14%	467,896.45	383,755.80	-17.98%
Total Operating Income	47,472,915	51,569,362	59,474,588	69,614,802	90,565,298	17.52%	59,312,697	81,634,846	37.63%
Net Interest Income	25,964,030	28,123,770	29,759,669	35,144,184	44,595,084	14.48%	32,363,307	41,544,100	28.37%
FX and Investment Activity	3,753,037	4,736,122	7,726,060	15,611,240	14,796,405	40.91%	8,745,888	2,447,454	-72.02%
Staff Costs	11,942,482	13,809,023	16,461,158	23,776,353	32,120,544	28.06%	21,621,582	29,928,517	38.42%
Other Operating Expense	12,211,459	13,377,245	14,586,267	16,180,020	25,674,925	20.42%	16,236,675	22,923,070	41.18%
Operating Profit	16,001,181	18,096,072	21,158,628	26,186,057	25,828,395	12.72%	17,097,996	21,959,207	28.43%
Profit Attributable to NCBFG	12,301,790	14,448,560	19,107,818	27,958,752	29,576,423	24.52%	20,748,727	14,778,316	-28.77%
Total Assets	523,815,161	607,669,433	693,724,191	978,584,626	1,610,101,135	32.41%	1,566,097,212	1,687,931,139	7.78%
Loans	165,404,606	189,055,786	218,615,226	372,634,701	423,102,600	26.47%	411,794,968	445,412,890	8.16%
Investment Securities	166,019,274	166,426,708	189,070,828	210,354,295	380,263,263	23.02%	371,185,308	454,119,593	22.34%
Customer Deposits	227,850,985	273,965,888	288,464,013	484,847,790	508,721,853	22.24%	509,017,498	545,677,003	7.20%
Other Borrowed Funds	8,595,313	12,061,154	38,649,556	65,558,639	128,975,616	96.82%	122,341,205	123,591,187	1.02%
Equity	88,394,211	103,105,310	115,993,769	130,040,568	146,561,077	13.47%	137,032,650	150,884,692	10.11%
Ratios						Average			% Change
P/E	5.50	7.07	11.21	10.93	17.15	10.37	16.59	13.98	-15.69%
P/B	0.77	0.99	1.85	2.35	3.46	1.88	3.39	2.20	-35.27%
Dividend Yield	8.39%	5.66%	3.10%	2.17%	1.63%	4.19%	1.32%	1.39%	5.57%
Cost to Income	58.78%	60.65%	60.25%	60.68%	67.87%	61.65%	67.05%	68.37%	1.97%
ROE	14.45%	15.09%	17.44%	22.73%	21.39%	18.22%	21.94%	16.40%	-25.27%
ROA	2.40%	2.55%	2.94%	3.34%	2.29%	2.70%	2.25%	1.45%	-35.40%
Debt to Equity	9.72%	11.70%	33.32%	50.41%	88.00%	38.63%	89.28%	81.91%	-8.25%
Dividend Payout Ratio	46.20%	40.03%	34.79%	23.71%	27.92%	34.53%	29.56%	30.85%	4.35%
Share Performance	53.40%	50.80%	109.69%	43.09%	67.68%	64.93%	52.20%	-34.66%	-166.39%
Main Market Performance	33.34%	70.76%	59.73%	36.38%	44.02%	48.85%	30.58%	-25.63%	-183.83%

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Financial Overview

Total Operating Income (TOI) at NCBFG has increased at a CAGR of 17.52% for the period FY 2015 to FY 2019 (period under review), to a record of \$90.57 billion. **Net interest income (NII) was the most significant contributor to FY 2019 TOI accounting for 49.24%**, the primary contributor to NII is loans and investment securities. **In FY 2019 NCBFG revenue growth was aided by a \$10.63 billion or 280% surge in net result from insurance activities.** The major contributor to increased revenue from insurance activities is GHL. **Furthermore, it is our expectation that FY 2020 core earnings expansion will be driven by GHL's performance.** Staff cost has remained a significant expense at NCBFG accounting for 49.62% of FY 2019 operating expenses. Staff cost increased at a CAGR of 28.06% for the period under review with most of the increases occurring in FY 2018 and FY 2019 due to the consolidation of Clarien and GHL respectively. **Therefore, we expect the growth in staff costs to subside in the near to medium-term.**

Total assets for NCBFG as at the end of FY 2019 stood at \$1.61 trillion, resulting in a CAGR of 32.41% for the period under review. Growth in total assets surged in FY 2019 by 64.53% or \$631.52 billion as a result of the consolidation of GHL. The most significant assets on NCBFG's balance sheet are loans & advances, investment securities and pledged assets (collateral for repos and life insurance) which account for 27.32%, 24.11% and 24.78% respectively of total assets. Loans have increased at a CAGR of 26.47% for the period under review, a major contributor was the consolidation of Clarien in FY 2018. In Q1 FY 2020 loans continued to advance reaching \$438.38 billion, a 17.38% increase over the corresponding period last year.

As at the end of FY 2019 total investment securities stood at \$385.26 billion, of which \$216.98 billion or 56.32% is in GOJ securities. **'Other Borrowed Funds' at the end of FY 2019 is primarily comprised of corporate notes of \$110.55 billion.** The corporate notes are denominated in both JMD and USD fixed and 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. The surge in 'borrowed funds' due to increased corporate notes is of concern. **In our debt-to-equity calculations above, we compute 'other borrowed funds' as a percentage of equity. As indicated, this has surged for the period under review, and as at the end of Q3 FY 2020 is 81.91% down for the same period the previous year. While we view the risk as moderate at current levels, our primary concern is a continued expansion.**

NCBFG's P/E ratio has increased significantly from a low of 3.40x as at the end of October 2014. P/E multiple expansion has been consistent for the period under review with the average P/E increasing each FY since FY 2015. 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, a similar trend can be observed with NCBFG's P/B ratio for the period under review. EPS has increased at a CAGR of 25% for the period under review, but NCBFG's share price has risen at a CAGR of 66% over the same period, which has resulted in P/E multiple expansion.

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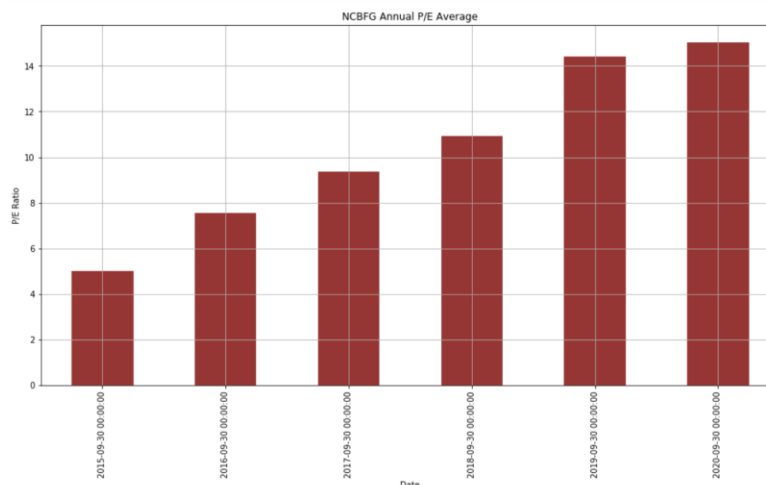
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Forecast and Valuation

We used our projection of NCBFG's FY 2021 EPS and BVPS and then applied the average P/B and P/E multiples of peers (adjusted for historical differences) to arrive at our price target of \$137.81. Innate in our base-case assumption is the sentiment towards large-cap financials remaining at recent levels. COVID-19 has reduced the average P/E of large-cap banks from about 16x in early 2020 to approximately 13x even as earnings fall. Seen on the chart below is the expanding P/E multiples of NCBFG's peers, indicating increased investor sentiment. However, it has diminished a bit from its August 2019 high of 18.6x. Also, below is a chart illustrating the relationship between NCBFG P/E and that of its peers. Similar patterns were observed for NCBFG versus peers on a P/B basis. For the upper and lower price targets, we used the peer average adjusted for historical high and low of P/E and P/B spread. **This resulted in our worst-case and best-case price targets of \$104.65 and \$190.52, respectively.**

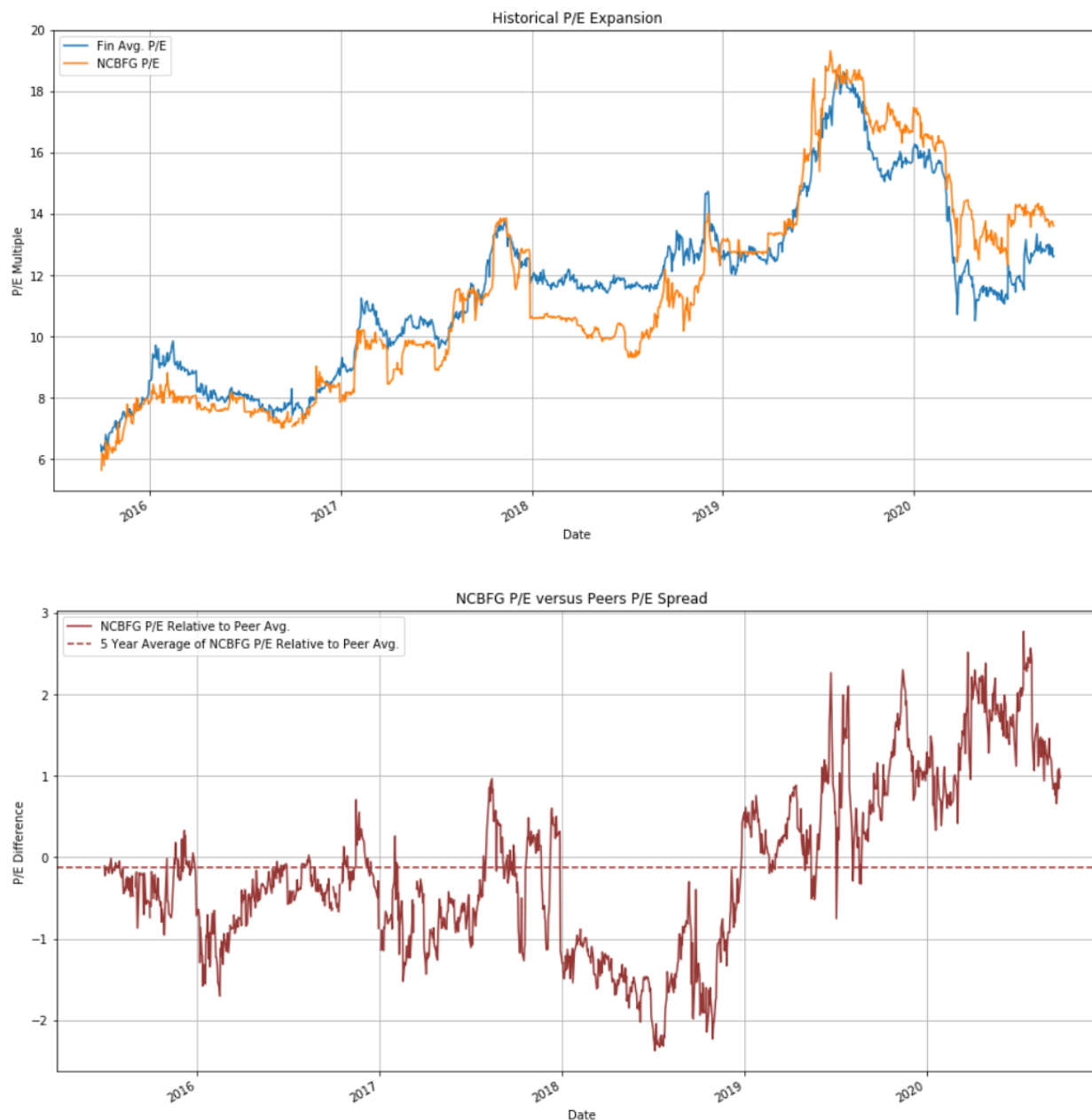
Using the Dividend Discounted Model (DDM), we arrived at a price target of \$159.89. Of note for our DDM model we anticipate NCBFG returning to its historical dividend pattern in the near-term however, there is significant risk that this may fail to materialize.

Large Cap Banks					
Ticker	Market Cap(\$M)	P/E	P/B	ROA	ROE
NCBFG	322,570.95	13.66	2.14	1.45%	16.40%
SJ	172,774.51	12.69	1.84	3.04%	15.43%
SGJ	146,267.04	16.31	1.33	1.64%	7.92%
JMMBGL	57,167.57	8.59	1.22	1.70%	16.44%
Average	174,695.02	12.81	1.63	1.96%	14.05%



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Outlook

We expect core earnings growth to continue to be driven by GHL, as synergies are realized. NCBFG recently received approval to transfer 100% of NCBIC's portfolio of insurance and annuities business to

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Guardian Life Limited (GLL), which will take effect on September 30, 2020. After the transfer, NCBIC will operate under a new company name and sell insurance products as an exclusive agent of GLL. Therefore, in FY 2021, we anticipate synergies from the merger of the business segment. While we expect growth in core earnings in FY 2021 we don't expect earnings to exceed FY 2019 levels. In the medium to long-term we expect core earnings to grow placing the company on a sustainable growth path, albeit at a slower rate than the recent past.

Key Risks to Our Price Target

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 54% of FY 2018 revenue. Additionally, investor sentiment on the stock could turn negative if the decline in earnings materializes.

Our price target implies that sentiment towards large-cap financial stocks (NCBFG peers), remains favourable. **A meaningful decline in investor sentiment towards large-cap financials could result in the stock declining below our base case expectations.** Despite NCBFG being geographically diversified 75% of FY 2019 earnings were generated in Jamaica, therefore the company may still be materially impacted by Jamaica's fortunes.

RECOMMENDATION:

We recommend a **MARKETWEIGHT** rating on NCBFG at this point given that the stock currently trades close to our **base-case price target of \$137.81**. We expect a decline in profitability in the near-term because of the economic slowdown and increased provisions for credit losses. However, NCBFG's ongoing investment in technology and increased offerings due to recent acquisitions are expected to result in core earnings growth in the medium to long-term.

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

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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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MARKETPERFORM/HOLD/MARKETWEIGHT—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

UNDERPERFORM/UNDERWEIGHT— ADJUST EXPOSURE IN YOUR PORTFOLIO HELD AT JMMB TO BETWEEN 2.5% AND 4.9% FOR THIS PARTICULAR ASSET

STRONGLY UNDERPERFORM/UNDERWEIGHT—REDUCE EXPOSURE TO THIS ASSET TO BELOW 2.5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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