

## NCB Financial Group Limited

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### Executive Summary

NCB Financial Group Limited (NCBFG) is incorporated and domiciled in Jamaica and is 51.75% owned by AIC (Barbados) Limited. The ultimate parent company of AIC is Portland Holdings Inc., which is domiciled in Canada. Hon. Michael A. Lee-Chin, OJ controls Portland Holdings Inc. and serves as Chairman of NCBFG. The Company currently has operations in Jamaica, Cayman Islands, Trinidad & Tobago, Barbados, Bermuda and the United Kingdom, and 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).

NCBFG profits attributable to shareholders increased at a CAGR of 7.2% for the period under review (FY 2016 to FY 2020). Meanwhile, total assets have grown at a CAGR of 32.41% to a record \$1.80 trillion aided by mergers and acquisitions.

NCBFG's stock price has increased at a CAGR of 33.3% for the period under review, outpacing the Main Market's increase of 23.3% over the same period. The Company's stock is relatively liquid, with an average daily volume (ADV) of approximately 270.5 thousand over the last year.



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### Recent Developments

In Q1 FY 2021, Net Operating Income increased 1.5% to \$33.8 billion, driven by a 7.3% increase in its Insurance Activities to \$8.6 billion. Meanwhile, the Banking and Investment segments net revenue fell due to a 9% reduction in fee and commission income to \$7 billion. The decline in fee income was due to reduced transaction volumes and increased use of lower-cost self-service and digital options.

Meanwhile, staff costs increased 15.6% to \$12.3 billion, resulting in operating profit declining 17.3% to \$8.2 billion. Ultimately profits attributable to shareholders fell 33.6% to \$3.9 billion due to a higher effective tax rate.

### Key Financial Data

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	CAGR	Q1 2020	Q1 2021	% Change
<b>BVPS</b>	41.80	47.02	52.72	59.83	63.29	10.93%	60.00	66.88	11.47%
<b>EPS</b>	5.87	7.76	11.39	12.11	8.01	8.08%	2.46	1.66	-32.52%
<b>Dividend Per Share</b>	2.35	2.70	2.70	3.40	1.90	-5.18%	0.90	-	N/A
<b>Share Price</b>	41.50	87.02	124.52	208.79	130.90	33.27%	196.64	143.23	-27.16%
<b>JSE Main Market</b>	164,482	262,729	358,320	516,043	380,426	23.32%	509,916	395,615	-22.42%
<b>(In Billions)</b>									
<b>Total Operating Income</b>	51.57	59.47	69.61	91.18	108.83	20.53%	33.29	33.78	1.48%
<b>Net Interest Income</b>	28.12	29.76	35.14	44.60	52.49	16.88%	13.93	13.82	-0.80%
<b>FX and Investment Activity</b>	4.74	7.73	15.61	15.41	8.79	16.73%	4.98	5.41	8.58%
<b>Staff Costs</b>	13.81	16.46	23.78	32.12	40.53	30.89%	10.65	12.32	15.61%
<b>Other Operating Expense</b>	13.38	14.59	16.18	25.67	31.10	23.48%	10.62	10.54	-0.74%
<b>Operating Profit</b>	18.10	21.16	26.19	26.44	27.26	10.79%	9.95	8.22	-17.32%
<b>Profit Attributable to NCBFG</b>	14.45	19.11	27.96	29.87	19.09	7.21%	5.90	3.92	-33.62%
<b>(In Billions)</b>									
<b>Total Assets</b>	607.67	693.72	978.58	1,616.30	1,800.26	31.19%	1,610.70	1,797.61	11.60%
<b>Loans</b>	189.06	218.62	372.63	423.10	452.95	24.41%	438.38	461.26	5.22%
<b>Investment Securities</b>	166.43	189.07	210.35	386.19	456.80	28.71%	386.81	386.26	-0.14%
<b>Customer Deposits</b>	273.97	288.46	484.85	504.68	573.97	20.31%	499.14	581.74	16.55%
<b>Other Borrowed Funds</b>	12.06	38.65	65.56	124.95	125.07	79.45%	130.91	131.11	0.15%
<b>Total Liabilities</b>	504.56	577.73	839.00	1,432.43	1,600.06	33.45%	1,423.83	1,600.06	12.38%
<b>Equity</b>	103.11	115.99	130.04	147.59	156.11	10.93%	148.00	164.98	11.47%

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## NCB Financial Group Limited

### Financial Overview

Total Operating Income (TOI) at NCBFG has increased at a CAGR of 20.53% for the period under review to a record of \$108.8 billion. Net Interest Income (NII) is the most significant contributor to revenues and increased 17.7% to \$52.5 billion. However, the Banking and Investment segment's revenue declined by 0.5% to \$76.4 billion due to a surge in credit impairment losses from \$4.8 billion to \$10.3 billion in FY 2020.

The insurance segment's significant improvement was due to only five months of GHL's performance reflected in FY 2019 versus 12 months in FY 2020. The full-year consolidation resulted in net revenue from insurance activities surging \$18 billion to \$32.5 billion.

NCBFG's primary operating geographic regions include Jamaica, Trinidad & Tobago, the Dutch Antilles and Bermuda. The Company's principal countries of operations have all experienced growth except for Jamaica in FY 2020. Meanwhile, the primary regions for generating operating income in FY 2020 are Jamaica (39%), Trinidad & Tobago (26%) and the Dutch Caribbean (17%).

Staff costs increased \$8.4 billion or 26.2% to \$40.5 billion, driven by the consolidation of GHL and salary increases. Meanwhile, other expenses increased by \$6 billion due to a rise in marketing, professional fees, and travel costs. The net result was operating profit rising 3.1% to \$27.3 billion in FY 2020. However, partly due to one-off gains, profits attributable to NCBFG shareholders was down 36.1% to \$19.1 billion.

NCBFG's total assets as at the end of FY 2020 stood at \$1.8 trillion, resulting in a CAGR of 31.2% for the period under review. NCBFG's assets grew by \$184 billion in FY 2020, primarily due to a surge in investment securities by \$70.6 billion. The primary assets on the Company's balance sheet are "Loans net of Provisions for Credit Losses" (25.2%), "Investment Securities" (25.4%) and "Pledged Assets" (22.3%). Loans net of credit losses increased \$29.9 billion despite increased provisions for credit losses due to gross loans growing 8.1% to \$467.4 billion. Meanwhile, GOJ debt securities classified as FVOCI was increased from \$217 billion to \$274.8 billion, which aided growth in "Investment Securities".

Total liabilities have increased at a CAGR of 33.5% for the period under review to \$1.6 trillion. Total liabilities pace of growth was due in part to the acquisition of GHL, which resulted in a surge in liabilities under annuity and insurance contracts. Meanwhile, at the end of FY 2020, the two primary liabilities on NCBFG's balance sheet are Customer Deposits and Insurance Contracts Liabilities of \$574 billion and \$405 billion, respectively.

The Company's Equity has increased at a CAGR of 10.9% to \$156.1 billion for the period under review. However, at the end of March 2020, equity dipped to \$136.6 billion due to the negative impact of COVID-19 on bond prices. Subsequently, it rebounded at the end of June 2020 to \$150.9 billion. Furthermore, NCBFG's equity continues to grow, rising to \$165 billion at the end of Q1 FY 2021.

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Ratios	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	Average	Q1 2020	Q1 2021	% Change
P/E	7.07	11.21	10.93	17.24	16.34	12.56	16.78	19.86	18.41%
P/B	0.99	1.85	2.36	3.49	2.07	2.15	3.28	2.14	-34.66%
Dividend Yield	5.93%	4.17%	2.69%	2.10%	1.14%	3.21%	0.44%	0.00%	N/A
Cost to Income	60.65%	60.25%	60.68%	67.43%	68.48%	63.50%	66.97%	73.13%	9.20%
ROE	15.09%	17.44%	22.73%	21.52%	12.57%	17.87%	20.27%	10.93%	-46.06%
ROA	2.55%	2.94%	3.34%	2.30%	1.12%	2.45%	2.22%	1.00%	-54.79%
Debt to Equity	11.70%	33.32%	50.41%	84.66%	80.11%	52.04%	88.45%	79.47%	-10.16%
Financial Leverage	5.91	5.94	6.80	9.35	11.25	7.85	9.13	10.89	19.30%
Dividend Payout Ratio	40.03%	34.79%	23.71%	28.08%	23.72%	30.07%	36.59%	0.00%	N/A
Share Performance	50.80%	109.69%	43.09%	67.68%	-37.31%	46.79%	-5.82%	9.42%	N/A
Main Market Performance	70.76%	59.73%	36.38%	44.02%	-26.28%	36.92%	-1.19%	3.99%	N/A

NCBFG has seen a material increase in its average annual P/E and P/B ratio for the period under review. The Company's average P/E increased from 7.6x in FY 2016 to 14.7x in FY 2020, a similar pattern was observed for the market. Meanwhile, for Q1 FY 2021, NCBFG's P/E averaged 17.5x due to trailing EPS falling at the end of FY 2020 while the stock price rallied 9.4%.

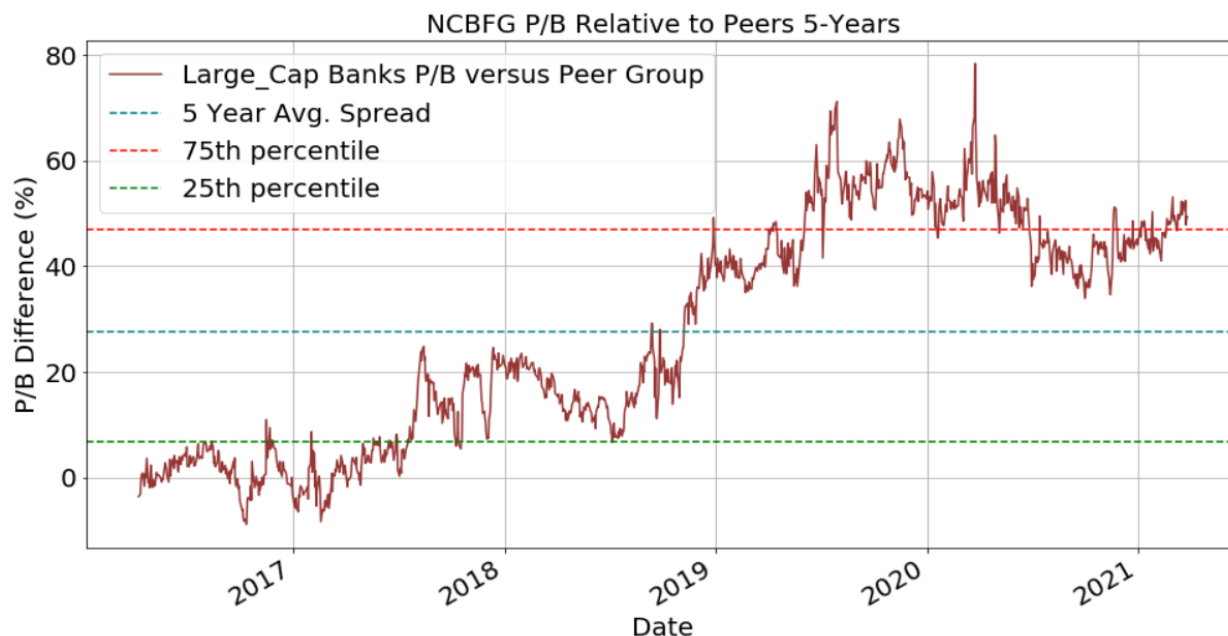
NCBFG's dividend yield has been declining over the years due to the stock price growth outpacing the dividend growth. However, more recently, in FY 2020, dividends fell to only \$1.90 due to the BOJ guidelines regarding payment of dividends to shareholders owning more than 1% of the Company.

### Forecast and Valuation

We used our projection of NCBFG's FY 2021 BVPS and then applied the harmonic mean P/B multiple of peers (adjusted for historical differences) to arrive at our price target of \$128.80. Essential to our price target is the assumption that investor sentiment towards NCBFG's peer group remains relatively stable. Below is a chart illustrating the relationship between NCBFG's P/B ratio and its peer group average over the last five years. As indicated below, on average, NCBFG's P/B ratio has exceeded peers by 27.7% over the previous five years. NCBFG's history of producing superior ROE relative to peers may explain this premium. We used the 75<sup>th</sup> and 25<sup>th</sup> percentile of P/B valuation difference to derive the upper and lower price targets of \$149.31 and \$108.49, respectively.

The chart below indicates that NCBFG's P/B ratio is currently trading near the 75<sup>th</sup> percentile. Historically NCBFG usually commands a modest premium to peers. However, we don't expect NCBFG to generate sufficient ROE in the future to warrant a significantly higher P/B ratio. Therefore we see the current high level of the P/B ratio relative to peers as a reflection of investors being overly negative on peers.

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Large Cap Banks					
Ticker	Market Cap(\$M)	P/E	P/B	ROA	ROE
NCBFG	332,963.41	19.46	2.02	1.00%	10.93%
SJ	194,841.56	14.14	1.83	2.90%	13.95%
SGJ	128,352.39	14.23	1.12	1.65%	7.71%
JMMBGL	62,968.79	9.10	1.06	1.53%	12.61%
<b>Average</b>	<b>179,781.54</b>	<b>13.24</b>	<b>1.39</b>	<b>1.77%</b>	<b>11.30%</b>

**Note: P/B and P/E averages are calculated using harmonic mean.**

### Outlook

We expect GHL to continue driving core earnings growth as synergies are realized. NCB Insurance Company (NCBIC) completed transferring its insurance and annuities business to GHL effective September 2020. NCBIC is now an insurance agent under its new name NCB Insurance Agency and Fund Managers Limited (NCBIAFM). NCBIAFM has ceased underwriting insurance products and now acts as an exclusive agent to GHL and will continue to provide pension fund management administration and investment management services. We expect increased efficiency to help lift NCBFG's FY 2021 earnings.

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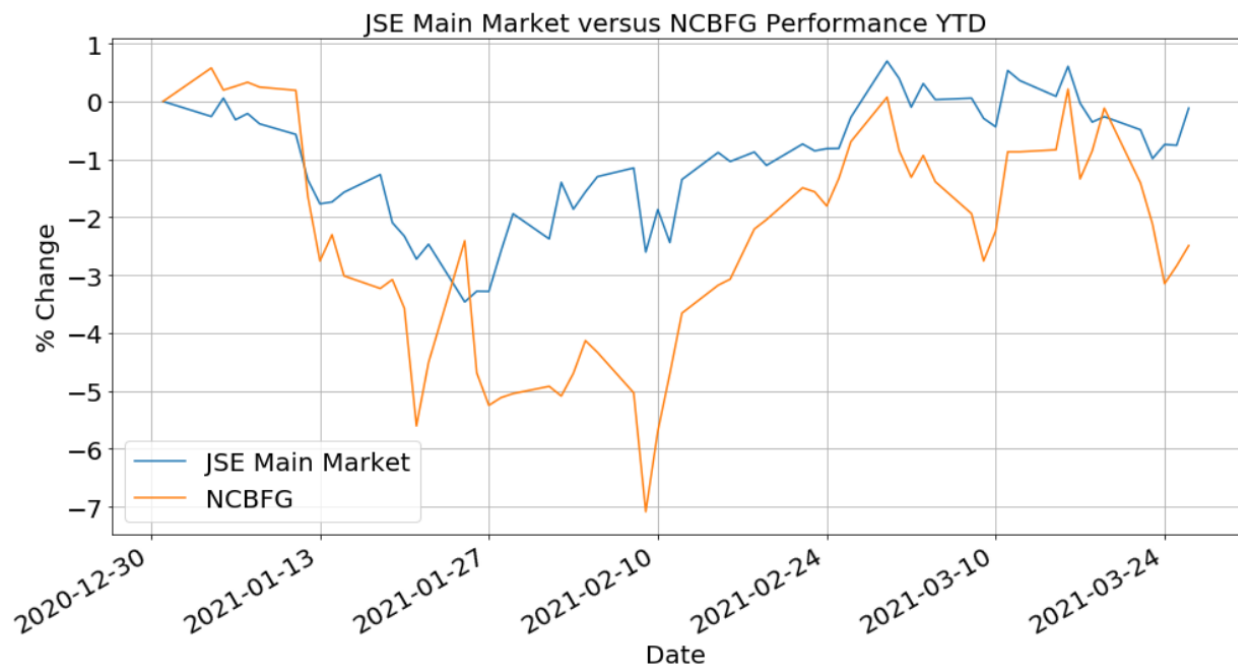
## NCB Financial Group Limited

Meanwhile, we expect growth to return to NCBFG's Banking and Investment Activities as expected credit losses decline and core revenue sources continue to grow.

### Recommendation:

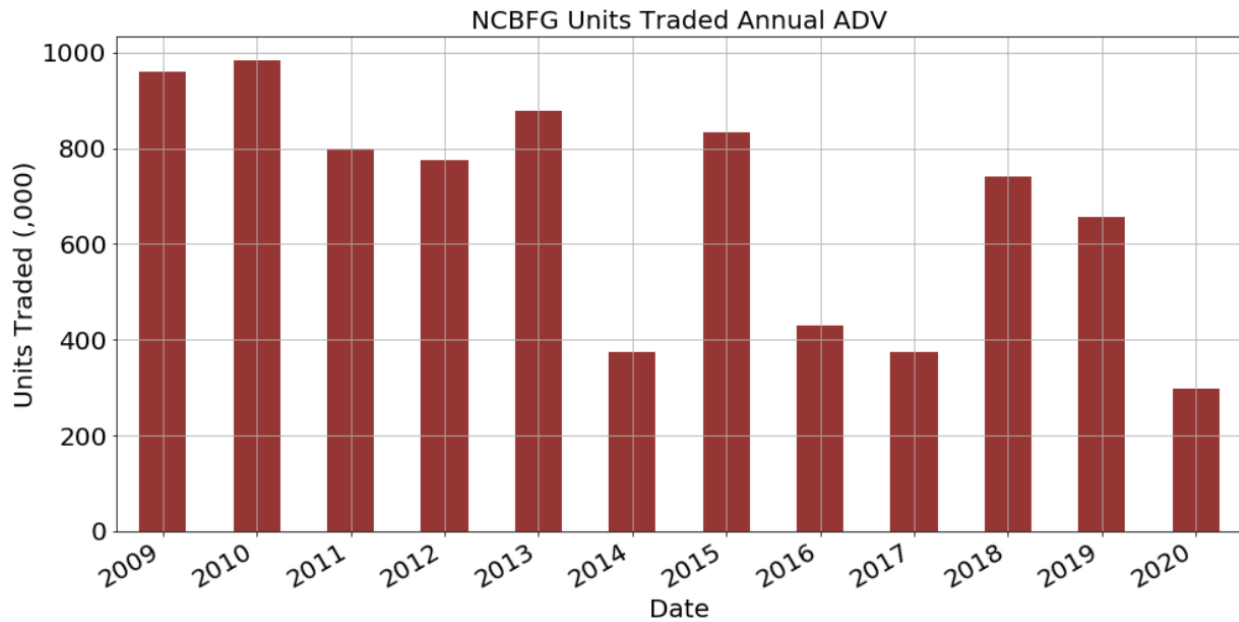
**We maintain our HOLD rating on NCBFG at this point, given that the stock currently trades roughly in line with our price target. Our recommendation considers the stability of NCBFG's balance sheet, geographic diversification and stock liquidity.** We expect pre-tax earnings for FY 2021 to exceed FY 2020. However, we project a decline in profits attributable to shareholders due to a higher effective tax rate.

**Our price target's primary risk is a meaningful decline in investor sentiment towards large-cap financials, resulting in the stock declining below our base case expectations.** Additional risks include credit losses exceeding provision, which could result in earnings significantly underperforming our expectations. Finally, if the global pandemic's negative impact on business increases due to variants or vaccine hesitancy, this could also cause the pace of recovery to underperform our projections.



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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**.

**PLEASE NOTE** THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

**OUTPERFORM/OVERWEIGHT/BUY**—EXPOSURE TO THIS ASSET SHOULD BE UP TO 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

**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

**SELL**—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO (0%).

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