INVESTMENT AND SOVEREIGN RESEARCH February-3-2022

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NCB Financial Group Limited

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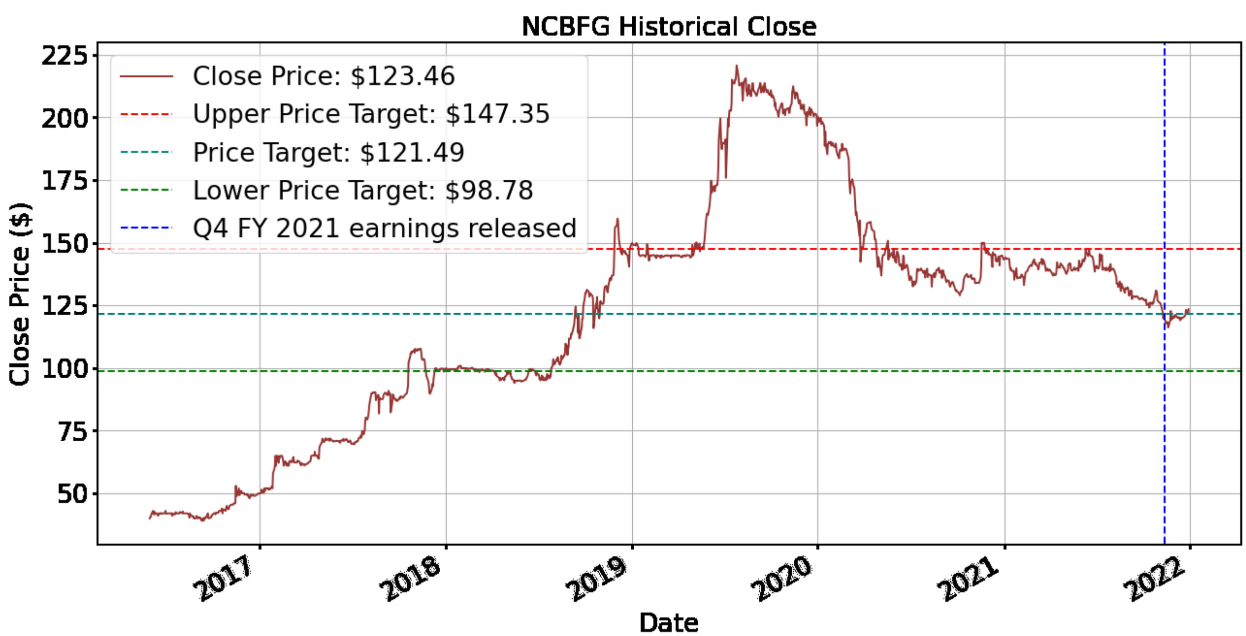
Executive Summary

NCB Financial Group Limited (NCBFG) is incorporated and domiciled in Jamaica and is 52.63% 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 has produced consistent growth on several vital measures, including net operating income, total assets, loans, customer deposits and equity. However, net profit attributable to NCBFG shareholders fell for the review period, primarily due to the negative impacts of COVID-19.

NCBFG currently trades at approximately 19.8x, its trailing 12-months EPS above the 12x harmonic mean of the peer group. Meanwhile, NCBFG is the most liquid listed entity, exchanging an average daily volume of 571.6K units over the past year, valued at approximately $80.6 million. Over the past month (December), NCBFG has had an average bid-ask spread of about 1%, indicating a relatively low implicit cost to acquire shares.



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Recent Developments

The strength of the Bank and Investment Activities (B&I) outweighed the weak results from Insurance Activities, resulting in mixed results for the 4th quarter ended September 2021. Net revenue from B&I Activities increased 35.7% to $24.4 billion. At the same time, net revenue from Insurance Activities fell 46.7% to $4.9 billion. A 32.3% surge in policyholders' and annuities benefits and reserves was the primary reason for the decline in net revenue from insurance activities.

Meanwhile, staff costs declined by 6.1% to $10 billion, which curtailed operating expenses to only increase 6.8% to $23.3 billion. Ultimately NCBFG produced profit attributable to shareholders of $4.3 billion in line with the prior Q4 results.

Key Financial Data (Table 1.)

	YE 2017	YE 2018	YE 2019	YE 2020	YE 2021	CAGR
BVPS	47.02	52.72	59.83	63.29	65.31	8.56%
Trailing EPS	7.76	11.39	12.11	8.01	6.25	-5.27%
Dividend Per Share	2.70	2.70	3.40	1.90	0.50	-34.40%
Price Per Share	87.02	124.52	208.79	130.90	127.52	10.02%
JSE Main Market	164,482	262,729	358,320	516,043	380,426	23.32%
Abridged Income Statement (in Billions)						
Net Operating Income	59.47	69.61	91.18	108.83	121.11	19.46%
Net Interest Income	29.76	35.14	44.60	52.49	56.98	17.63%
Gain on FX & Investment Activities	7.73	15.61	15.41	8.79	14.48	17.00%
Net result from Insurance Activities	-	3.80	14.43	32.46	22.95	82.16%
Staff costs	16.46	23.78	32.12	40.53	44.50	28.23%
Other operating expenses	14.59	16.18	25.67	31.10	39.20	28.04%
Operating Profit	21.16	26.19	26.44	27.26	26.26	5.54%
NCBFG Shareholders Profits	19.11	27.96	29.87	19.09	14.23	-7.11%
Abridged Balance Sheet (in Billions)						
Total Assets	693.72	978.58	1,616.30	1,800.26	1,921.40	29.01%
Loans	218.62	372.63	423.10	452.95	523.49	24.40%
Investment Securities AFS	189.07	210.35	386.19	456.80	683.86	37.91%
Customer deposits	288.46	484.85	504.68	573.97	642.96	22.19%
Other borrowed funds	38.65	65.56	124.95	125.07	136.97	37.21%
Total liabilities	577.73	839.00	1,432.43	1,600.06	1,714.70	31.26%
Equity	115.99	130.04	147.59	156.11	161.09	8.56%
Ratios						**Average**
P/E	11.21	10.93	17.24	16.34	20.40	15.23
P/B	1.85	2.36	3.49	2.07	1.95	2.34
Dividend Yield	4.17%	2.69%	2.10%	1.14%	0.36%	2.09%
Cost to Income	55.49%	60.68%	67.43%	68.48%	0.00%	50.41%
ROE	17.44%	22.73%	21.52%	12.57%	8.97%	16.65%
ROA	2.94%	3.34%	2.30%	1.12%	0.76%	2.09%
Debt to Equity	33.32%	50.41%	84.66%	80.11%	85.03%	66.71%
Financial Leverage	5.94	6.80	9.35	11.25	11.73	9.01
Dividend Payout Ratio	34.79%	23.71%	28.08%	23.72%	8.00%	23.66%
Share Performance	109.69%	43.09%	67.68%	-37.31%	-2.58%	36.11%
Main Market Performance	70.76%	59.73%	36.38%	44.02%	-26.28%	36.92%

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Financial Overview

Income Statement Review

Net Operating Income (NOI) has consistently increased over the review period; however, the growth rate slowed in FY 2021. It grew at a CAGR of 19.5% for the review period but slowed to 11.3% in FY 2021. The Banking & Investment (B&I) activities increase of 28.5% drove the increase in NOI. At the same time, net revenue from Insurance Activities fell 29.3%, which negatively impacted NOI.

B&I Activities improved in all areas in FY 2021; notably, FX and Investment Activities (FX & IA) and reduced credit impairment losses contributed significantly. FX and IA surged 159.6% to a high of $22.8 billion. A significant improvement component was unrealised gains on fair value through profit and loss securities of $3 billion versus a loss of $1.2 billion the prior year. At the same time, credit impairment charges declined from $10.3 billion in FY 2020 to $3.4 billion in 2021. The FY 2021 credit impairment charge was relatively low compared to the $4.8 billion recorded in FY 2019 pre-COVID-19. The decline was primarily due to credit impairment on loans moving from $11 billion in FY 2020 to $1.8 billion in FY 2021.

The two primary drivers of operating expenses are staff and other operating expenses. FY 2021 saw a 16.3% increase to $94.9 billion; however, staff costs only increased by 9.8%. A staff profit share of $3.2 billion in FY 2021 versus $444.2 million the prior FY drove the increase in staff costs. At the same time, other operating expenses surged 26.1% to $39.2 billion due to a surge in Technical, consultancy and professional fees (TCP Fees). TCP fees increased by 177.9% to $9.9 billion, adding $6.4 billion to other operating expenses. The increase was linked to investment in technology and digital channel enhancements to transform the business.

Balance Sheet Review

The primary contributors to total assets are loans, investment securities and pledged assets. Total assets have consistently increased for the period under review, but growth slowed to 6.7% in FY 2021. The reduced FY 2021 growth rate relative to the review period was primarily due to the unusual surge experienced in FY 2019, when total assets grew by 65.2%. The consolidation of Guardian Holdings Limited (GHL) resulted in the FY 2019 total assets spike.

Investment Securities are the most significant contributor to total assets and consistently increased under the review period. Growth of investment securities accelerated in FY 2021 by 49.7% to $683.9 billion. The primary reason for the surge of investment securities was a reduction in pledged assets from $396.3 billion to $216.7 billion. Therefore it will be challenging to replicate similar growth in subsequent periods.

Net loans consistently increased under the review period and accounted for 27.3% of total assets at the end of FY 2021. A 16.7% reduction in provision for credit losses assisted in improved net loans, but growth slowed in FY 2021 to 15.6% from a CAGR of 24.4%. The provision for credit losses as a portion of gross loans and advances improved to 2.9% in FY 2021 versus 4% in FY 2020. In fact, FY 2021 figure was better than the 3% recorded in FY 2019 pre-COVID-19 negative impact.

Equity attributable to NCBFG shareholders has consistently increased for the period under review reaching $161.1 billion at the end of FY 2021. However, equity only increased 3.2% in FY 2021. Primary contributors to this growth were a 42.1% surge in fair value and capital reserves to $17.4 billion. Additionally, retained earnings reserve increased 11.5% to $65.3 billion. Conversely, treasury shares rose 79.5% to $27.2 billion, curtailing equity growth.

Liabilities primary constituents are customer deposits and liabilities under annuity and insurance contracts. At the end of FY 2021, customer deposits account for 33.5% of total assets, and it remains a primary source of funding for the group's operations. Meanwhile, liabilities under annuity and insurance contracts account for 22.5% of total assets in FY 2021. The main constituent is life and health insurance and annuity contracts accounting for 88.8%.

Ratios Review

NCBFG P/E has increased from the levels seen at the end of FY 2019. The increase is primarily due to the decline in EPS outpacing the share price decline. In fact, NCBFG currently has the highest P/E ratio among large-cap diversified financials. At the same time, the P/B ratio has declined materially from FY 2019 figures.

NCBFG's dividend yield has declined for the review period due to a confluence of a higher price per share and a decline in dividends since FY 2019. While we expect improved dividends in FY 2022 and beyond, it may take several years for NCBFG to return to amounts paid in FY 2019, especially if the historical dividend payout ratio is maintained.

NCBFG's efficiency ratio has consistently deteriorated over the review period reaching its worst levels in FY 2021. The efficiency ratio reached a high of 76.2%, driven by costs outpacing revenue growth. As discussed previously, a significant driver of expenses in FY 2021 was TCP Fees.

Forecast and Valuation

We used our projection of NCBFG's FY 2022 EPS and BVPS and then applied the harmonic mean P/E and P/B multiple of peers (adjusted for historical differences) to arrive at our price target of $121.49. Crucial to our price target is the assumption that investor sentiment towards NCBFG's peer group remains relatively stable. Below are charts illustrating the relationship between NCBFG's P/B and P/E ratios relative to its peer group average over the last five years. **We used the 85th and 15th percentile of the P/B and the P/E valuation difference to derive our upper and lower price targets of $147.35 and $98.78, respectively.**

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Chart 1 below indicates that NCBFG's P/E is trading at a 65.2% premium to the peer group. On average, market participants exchange NCBFG's stock with a 14.9% P/E premium relative to peers over the last five years. We see this premium as unjustified given that NCBFG currently has a lower ROA than its peers, and its ROE exceeds only Scotia Group (SGJ). While we expect NCBFG to grow its earnings in FY 2022, we don't expect levels sufficient to justify this premium.

At the same time, NCBFG's P/B ratio is approximately at a 32.3% premium to peers, in line with the 5-year historical average of 33.3%. While NCBFG's P/B valuation premium seems more reasonable than the P/E valuation premium, both could decline if NCBFG cannot meet market expectations. Our price target reflects our forecasted earnings growth of about 15% in FY 2022.

Table 2.

Large Cap Diversified Financials					
Ticker	**Market Cap($B)**	**P/E**	**P/B**	**ROA**	**ROE**
NCBFG	304.55	19.75	1.74	0.76%	8.97%
SJ	219.77	13.23	1.92	3.31%	15.29%
SGJ	117.03	13.91	1.03	1.49%	7.50%
JMMBGL	75.50	7.33	1.17	2.00%	17.96%
Mean	179.21	11.96	1.37	1.89%	12.43%

Chart 1.

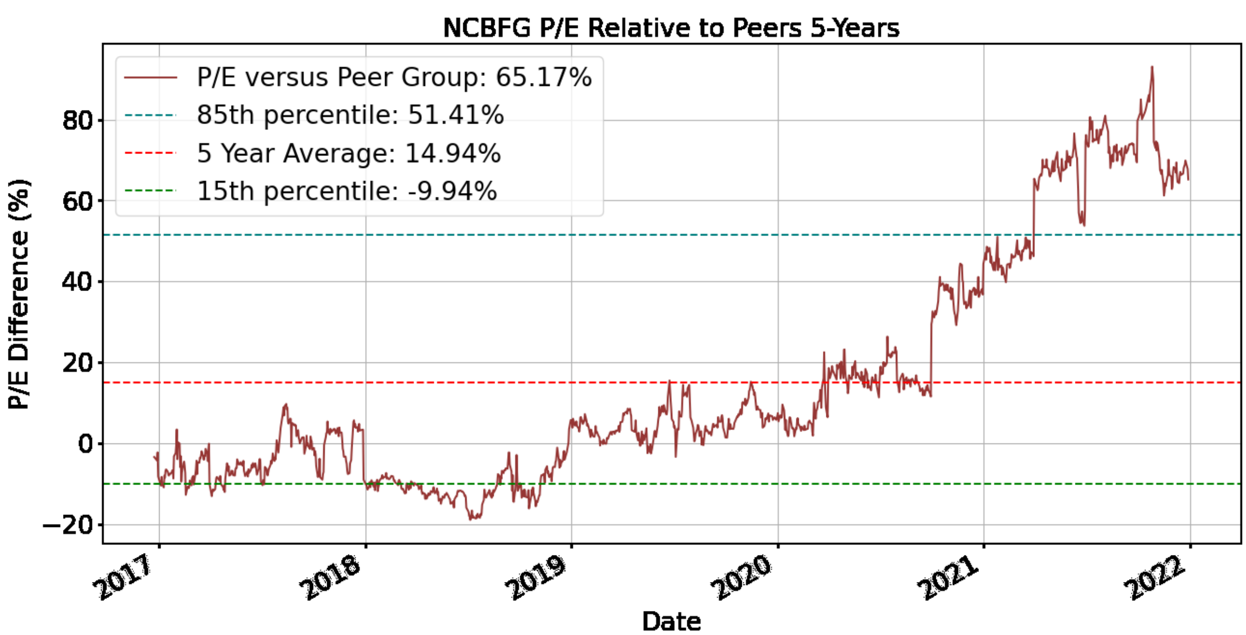
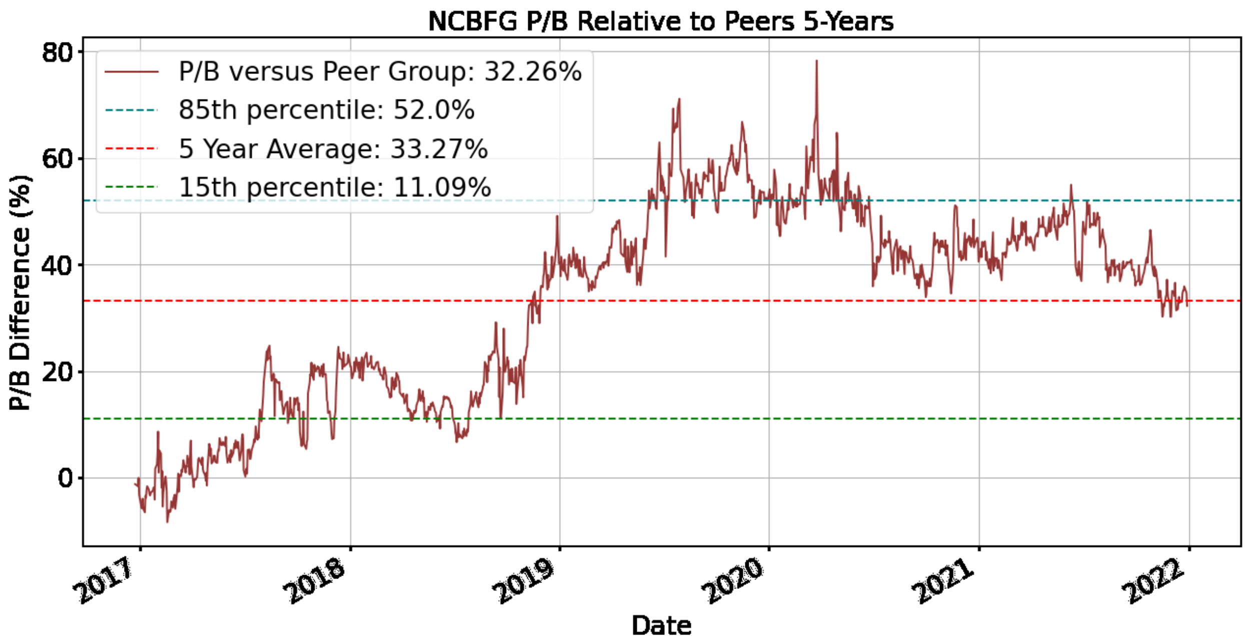


Chart 2.



Outlook

We expect both B&I and Insurance Activities to improve in FY 2022 and beyond, aiding our view for improved performance. Additionally, we see our estimates (see table 3.) for FY 2022 as conservative and below FY 2020 EPS because our forecast includes elevated credit impairment charges and TCP fees. Furthermore, the floods in Germany and increased mortality claims in Jamaica due to COVID-19 negatively impacted GHL's earnings. Consequently, we expect material improvement in GHL's earnings in FY 2022 and beyond.

Table 3.

FY	Q1	Q2	Q3	Q4	YE
2022	2.25E	1.05E	2E	1.93E	7.23E
2021	1.66	0.82	1.70	2.07	6.25

Table 4.

	Price Target	Implied Upside/(Downside)
Upper	147.35	19.35%
Base	121.49	-1.60%
Lower	98.78	-19.99%

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Recommendation:

We maintain our HOLD rating on NCBFG at this point, given that the stock currently trades marginally above our price target. Our recommendation considers the stability & growth probability of earnings, geographic & operating diversification, and share liquidity.

Our price target's primary risk is a meaningful decline in investor sentiment towards large-cap diversified financials, resulting in the stock declining below our base case expectations. As business operations normalise, we expect earnings to increase from FY 2021 depressed levels. However, in our opinion, current market prices already reflect modest growth expectations.

NCBFG has declined 13.8% YTD, underperforming the JSE Main Market advance of 0.4% over the same period. The Company's stock is the most liquid listing, trading an average daily value of approximately $80.6 million or 571.6K units over the last year. However, large block transactions such as the $13.8 billion in value traded on July 17, 2021 would impact this calculation. **See charts 3 – 6 below for more information on NCBFG's YTD performance, the volume traded, value exchanged, and historical closing bid-ask spread.**

Chart 3.

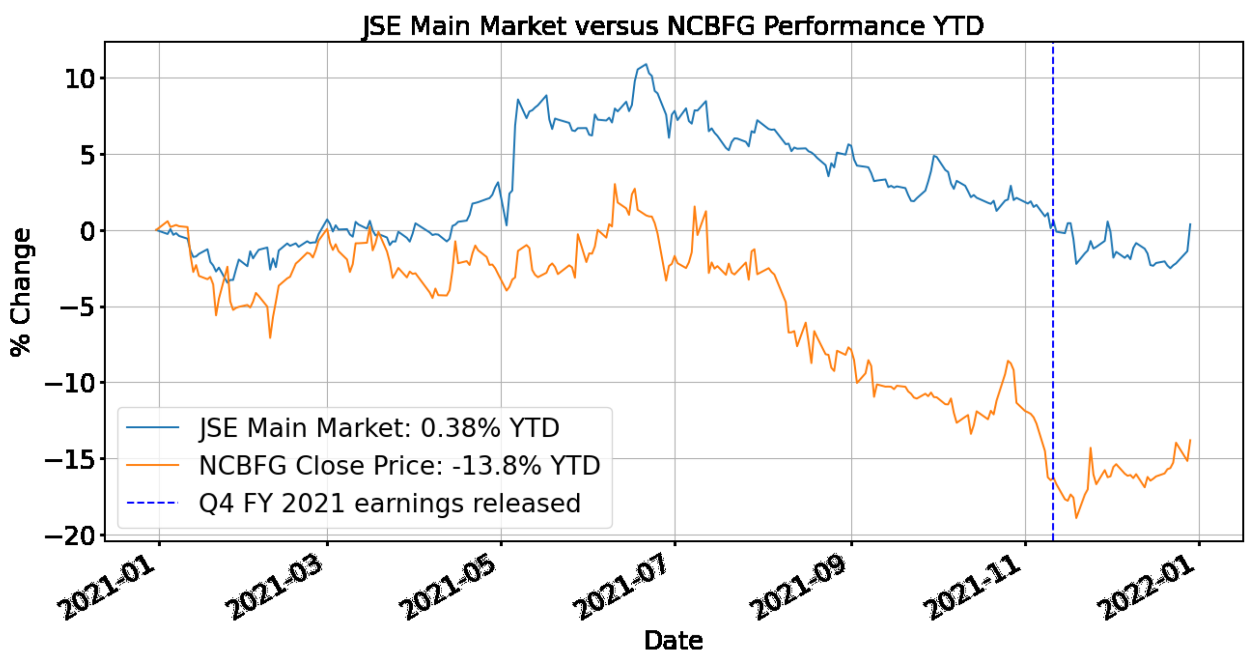

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Chart 4.

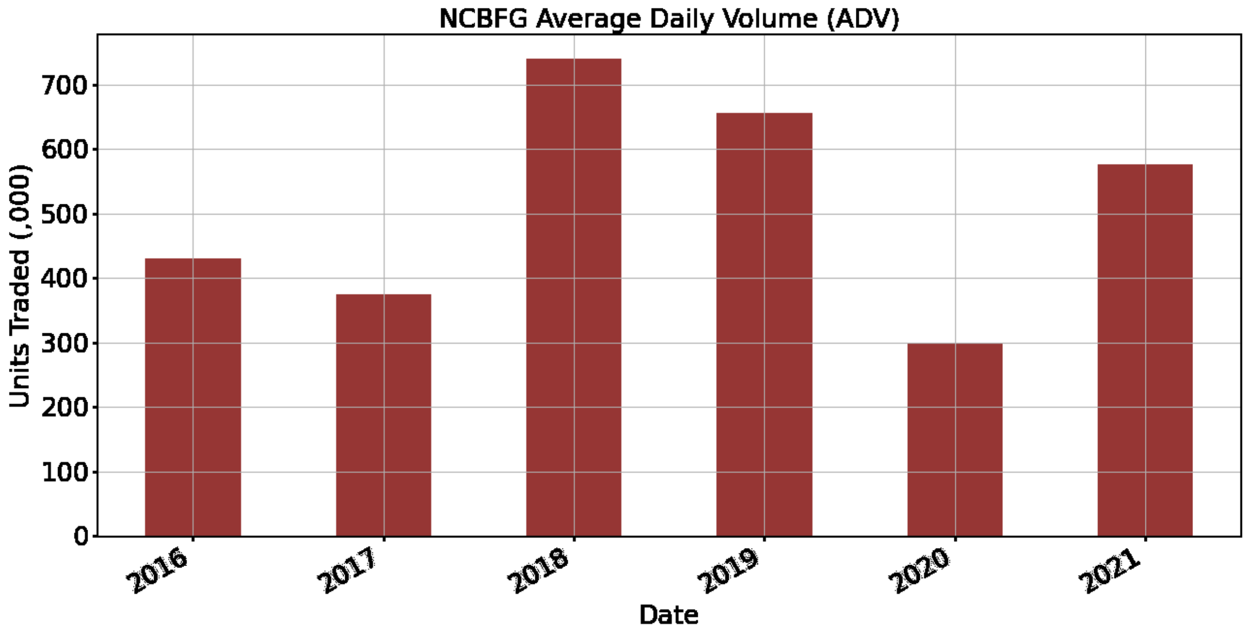

Chart 5.

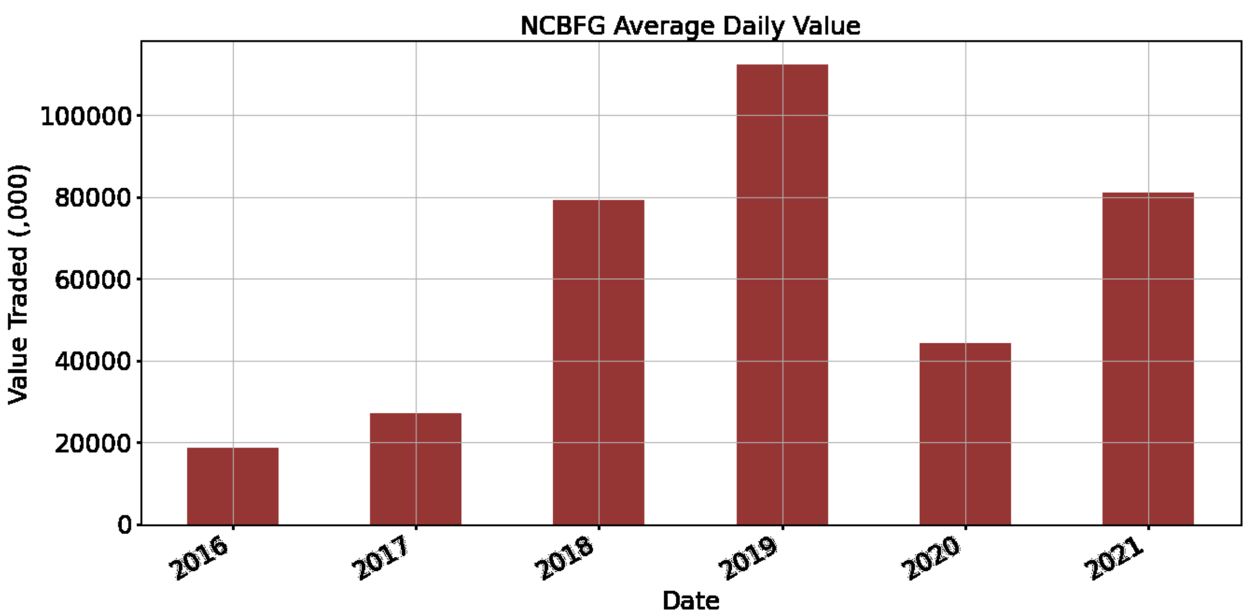

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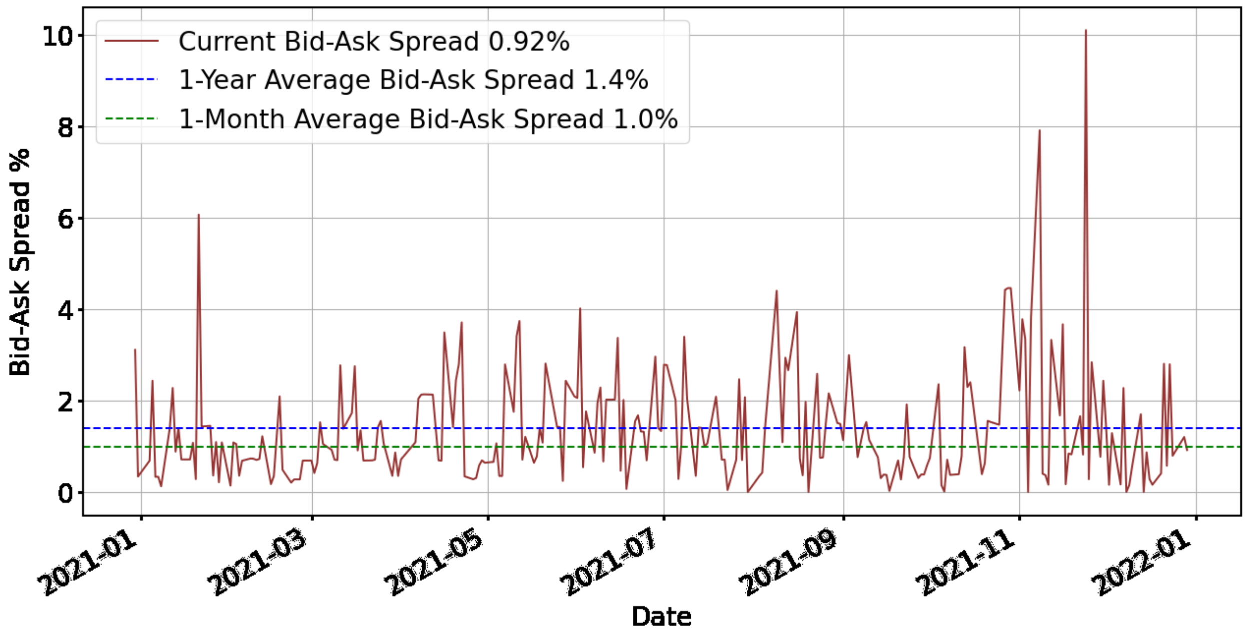
Chart 6.



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

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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