Cytonn INVESTMENTS

UBA PLC – FY'2018
25th March, 2019

Valuation Summary

- We are of the view that UBA PLC is a "***Buy***" with a target price of NGN 10.7, representing an upside of 48.1%, from the current price of NGN 7.8 as of 25th March, inclusive of a dividend yield of 10.9%,
- UBA PLC is currently trading at P/TBV of 0.6x and a P/E of 3.4x vs an industry average of 1.2x and 7.5x, respectively.

Key Highlights FY'2018

- The Bank successfully launched a Virtual social media Banking Chatbot dubbed Leo, which debuted on Facebook in January 2018, on WhatsApp in September 2018. This new tool will enhance client service by allowing the Bank's customers to fulfil their banking transactions through simple chat commands;
- The bank was feted at the International Finance Awards as the '2018 Most Innovative Digital Bank' in the digital category.

Income Statement

- Core earnings per share increased by 1.4% to NGN 2.3 from NGN 2.27 in FY'2017, contrary to our expectation of a 16.0% increase to NGN 2.7. Performance was driven by a 5.6% decline in total operating income, coupled with the 9.3% decline in the total operating expenses. The variance in core earnings per share growth against our expectations was largely due to a slower than expected growth in total operating income. We expected a 10.6% growth in total operating income but this declined by 5.6% to NGN 308.2 bn, largely due to the faster than expected 13.8% decline in NFI,
- Total operating income declined by 5.6% to NGN 308.2 bn in FY'2018 from NGN 326.6 bn in FY'2017. This was due to a 13.8% decline in Non-Funded Income (NFI) to NGN 102.6 bn from NGN 118.9 bn in FY'2017, coupled with the 1.0% decline in Net Interest income (NII) to NGN 205.6 bn from NGN 207.6 bn in FY'2017,
- Interest income rose by 11.4% to NGN 362.9 bn from NGN 325.7 bn in FY'2017, largely due to the 34.1% increase in interest income on government securities to NGN 154.2 bn from NGN 114.9 bn in FY'2017, coupled with the 85.2% increase in Interest income on loans to banks to NGN 3.7 bn in FY'2018 from NGN 2.0 bn in FY'2017. However, interest income on loans and advances to customers declined by 3.8% to NGN 194.9 bn from NGN 202.7 bn in FY'2017. Consequently, the yield on interest earning assets rose to 12.14% in FY'2018 from 12.09% in FY'2017,
- Interest expense rose by 33.3% to NGN 157.3 bn from NGN 118.0 bn in FY'2017, largely due to a 48.3% increase in the interest expense on borrowings to NGN 35.2 bn from NGN 23.7 bn in FY'2017, a 36.0% increase in interest expense on customer deposits to NGN 106.0 bn from NGN 78.0 bn in FY'2017, and a 73.8% increase in interest expense on placement liabilities to NGN 7.1 bn from NGN 4.1 bn in FY'2017. The cost of funds thus rose to 4.2% from 3.8% in FY'2017. Net Interest Margin declined to 6.6% from 7.7% in FY'2017,
- Non-Funded Income (NFI) declined by 13.8% to NGN 102.6 bn from NGN 118.9 bn in FY'2017. The decline in NFI was driven by a 35.4% decline in net trading and foreign exchange trading income to NGN 31.7 bn from NGN 49.1 bn in FY'2017, which declined largely due to the 25.5% decline in foreign exchange trading income to NGN 20.9 bn from NGN 40.2 bn in FY'2017, coupled the foreign currency revaluation loss of NGN 31.5 bn in FY'2018, from a foreign currency revaluation gain of NGN 1.0 bn in FY'2017. Total fees and commission income declined albeit marginally by 0.8% to NGN 65.4 bn from NGN 66.0 bn in FY'2017. As a result of the above performance, the revenue mix shifted to 67:33 funded to non-funded income as compared to 64:36 in FY'2017, as the proportion of NFI to total revenue decreased its faster decline,

- Total operating expenses declined by 9.3% to NGN 201.9 bn from NGN 222.5 bn in FY'2017, largely driven by an 86.2% decrease in Loan Loss Provision (LLP) to NGN 4.5 bn from NGN 32.9 bn in FY'2017, as the bank charged it provisions on its regulatory risk reserve, on implementation of IFRS 9, The decline in LLP outpaced the 3.2% increase in staff costs to NGN 71.2 bn in FY'2018 from NGN 69.0 bn in FY'2017, and the 3.4% increase in other operating expenses to NGN 114.4 bn from NGN 110.6 bn. The increase in staff costs was as a result of the staff head count rising by 8.3% to 12,909 in FY'2018, from 11,925 in FY'2017, as the bank added 984 staff,
- The cost to income ratio improved to 65.5% from 68.1% in FY'2017, owing to the faster decline in expenses. However, without LLP, the Cost to Income Ratio (CIR) deteriorated, to 64.0% from 58.1% in FY'2017, highlighting the significant decline in the cost of risk to 1.0% from 10.1% in FY'2017,
- Profit before tax increased by 2.4% to NGN 106.8 bn, up from NGN 104.2 bn in FY'2017. Profit after tax increased by 1.4% to NGN 106.8 bn in FY'2018 from NGN 104.2 bn in FY'2017, as the effective tax rate rose to 26.4% from 25.6% in FY'2017,
- The bank declared a final dividend of NGN 0.65, similar to that of FY'2017, and in addition to the NGN 0.20 interim dividend. This translates to a dividend yield of 10.9%, and a payout ratio of 37.0%.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 19.7% to NGN 4.9 tn from NGN 4.1 tn in FY'2017. This expansion was largely driven by a 34.6% increase in government securities to NGN 1.6 tn from NGN 1.2 tn in FY'2017, coupled with the 3.6% growth in the loan book to NGN 1.7 tn from NGN 1.6 tn in FY'2017,
- Total liabilities rose by 23.4% to NGN 4.4 tn from NGN 3.5 tn in FY'2017, driven by a 22.5% increase in the customer deposits to NGN 3.3 tn, from NGN 2.7 tn in FY'2017, coupled with the 36.1% increase in borrowings to NGN 683.5 bn in FY'2018 from NGN 505.2 bn, as the bank received tranches of its issued Eurobond of USD 500.0 mn. The bank is yet to disclose the number of branches as at FY'2018,
- The faster growth in deposits as compared to the loans led to a decline in the loan to deposit ratio to 51.2% from 60.4% in FY'2017,
- Gross Non-Performing Loans (NPLs) rose by 1.7% to NGN 116.7 bn in FY'2018 from NGN 114.8 bn in FY'2017, which was attributed to key names within the general commerce, construction and real estate sectors. The NPL ratio improved to 6.7% from 7.1% in FY'2017 owing to the faster growth in loans. Loan Loss Provisions (LLPs) increased by 58.8% to NGN 92.1 bn from NGN 58.0 bn in FY'2017 and as a consequence, the NPL coverage rose to 79.0% in FY'2018 from 50.6% in FY'2017,
- Shareholders' funds decreased by 5.4% to NGN 483.5 bn in FY'2018 from NGN 511.2 bn in FY'2017, weighed down by the 17.1% decline in other reserves to NGN 199.6 bn from NGN 240.9 bn, as the bank passed provisions on its regulatory risk reserve as allowed for on the initial implementation of IFRS 9,
- UBA PLC currently has a return on average assets of 1.8% and a return on average equity of 15.8%.

Key Take-Outs:

- The bank registered a rapid expansion of its balance sheet, as the assets expanded by 19.7%, with the bulk of the investments being made into the relatively lower yielding government securities, as loans expanded by 3.6%. The bank's funding came from deposits which increased by 22.5%, aided by the bank's strong regional presence across 51 countries in Africa, although the deposits came at a higher cost, as they contributed to the 33.3% increase in interest expenses. Thus, with the increase in expenses unmatched by the increase in interest income, the bank was unable to grow its NII,
- The bank recorded a significant decline in NFI, which declined 13.8%, largely due the foreign currency revaluation losses, given that the bank recorded expansion in its transactional income. It remains

unclear why the bank incurred such huge losses given that the Nigerian Naira did not record a significant depreciation against the dollar and other major currencies in 2018, and,

- The bank recorded a deterioration in its operational efficiency, driven largely by the rise in staff costs, as the bank increased their staff head count by 984, and other operational expenses such as the banking sector resolution costs, which includes contributions to the Asset Management Company of Nigeria (AMCON). Due to the rising costs coupled with declining income, the efficiency deteriorated, to the highest CIR since FY'2015,

Going forward, we expect the bank's growth to be further propelled by

I. Regional diversification is likely to aid the bank in growing top line revenue. However since regional expansion comes at a cost the bank would be better placed at managing the rising inefficiencies, through leveraging on alternative banking channels, as opposed to the traditional brick and mortar model. The benefits of digital channels are two-fold, since they contribute in revenue expansion as well as cost containment, thereby aiding the bank to obtain sustainable growth.

Below is a summary of the bank's performance:

Balance sheet Items (bn)	FY'2017	FY'2018	y/y change	FY'2018e	Expected y/y change	Variance in Actual Growth vs Expected
Government Securities	1216.1	1637.1	34.6%	1519.3	(5.3%)	5.2%
Net Loans and Advances	1671.5	1731.1	3.6%	1792.0	(12.3%)	(0.8%)
Total Assets	**4069.5**	**4869.7**	**19.7%**	**4648.3**	**2.4%**	**(4.4%)**
Customer Deposits	2733.3	3349.1	22.5%	3225.0	8.6%	1.7%
Total Liabilities	3540.0	4367.1	23.4%	4139.7	6.3%	(6.9%)
Shareholders Fund's	**511.2**	**483.5**	**(5.4%)**	**488.1**	**(1.5%)**	**(6.7%)**

Balance sheet Ratios	FY'2017	FY'2018	% y/y change
Loan to Deposit Ratio	60.4%	51.2%	(9.2%)
Return on Average Equity	16.4%	15.8%	(0.6%)
Return on Average Assets	2.0%	1.8%	(0.3%)

Income Statement	FY'2017	FY'2018	y/y change	FY'2018e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	207.6	205.6	(1.0%)	236.2	13.7%	14.7%
Net non-interest Income	118.9	102.6	(13.8%)	125.1	5.2%	18.9%
Total Operating income	**326.6**	**308.2**	**(5.6%)**	**361.3**	**10.6%**	**16.2%**
Loan Loss Provision	(32.9)	(4.5)	(86.2%)	(34.4)	4.7%	90.9%
Total Operating Expenses	(222.5)	(201.9)	(9.3%)	(243.3)	9.3%	18.6%
Profits Before Tax	104.2	106.8	2.4%	118.2	13.4%	11.0%
Profits After Tax	**77.5**	**78.6**	**1.4%**	**91.0**	**17.4%**	**16.0%**
Core EPS	**2.3**	**2.3**	**1.4%**	**2.7**	**17.4%**	**16.0%**

Income Statement Ratios	FY’2017	FY’2018	y/y change
Yield from Interest Earning assets	12.09%	12.14%	0.0%
Cost of Funding	3.8%	4.2%	0.4%
Net Interest Spread	8.3%	8.0%	(0.3%)
Net Interest Margin	7.7%	6.6%	(1.1%)
Cost of Risk	10.1%	1.5%	(8.6%)
Net Interest Income as % of Operating Income	63.6%	66.7%	3.1%
Non-Funded Income as % of Operating income	36.4%	33.3%	(3.1%)
Cost to Income Ratio	58.1%	64.0%	6.0%