Quarterly Update

Rating
BUY

LATAM (Caribbean)

Sector: Finance
Industry: Banking, Insurance, Wealth Management

NCB FINANCIAL GROUP LIMITED

JSE	Bloomberg
NCBFG	NCBFG JA

Financial Overview

Revenues & Profitability

Following NCBFG's most profitable financial year (FY-2022), the Group reported a decline in profitability over the first nine months of FY-2023, primarily attributed to underperformance in its insurance segment.

Over the first nine months in FY 2023, NCBFG generated net operating income (NOI) of J$96.8 billion, but this was 8.3% lower than the amount generated in the similar period in FY 2022. This relatively weak performance was mainly driven by its insurance segment which reported net results that were J$13.6 billion lower compared to the previous year. During the initial nine months of FY 2023, the results of the insurance segment were negatively impacted by a one-off actuarial adjustment, negative movements in its reserves due to the usual periodic assumption updates and customers choosing to undergo elective procedures which may have been postponed during the pandemic.

It is important to note that the results presented by the Group were prepared in accordance with IFRS 4 – Insurance Contracts. While its insurance subsidiary, Guardian Holding Ltd., adopted IFRS 17 – Insurance Contracts, effective January 1, 2023, NCBFG is set adopt the new standard at the commencement of its upcoming financial year (FY 2024). This adoption will materially change the presentation of the financial statements going forward. IFRS 17 requires companies to measure insurance contracts with updated estimates and assumptions, reflecting the timing of cash flows and the inherent uncertainty associated with insurance contracts (the risk adjustment).

Insurers will now be required to indicate the expected (unearned) profit with the contractual service margin, and recognize the profit exclusively upon providing the insurance service. This change aims to harmonize the insurance sector's practices with those of other industries, making it easier to evaluate the performance of insurers against each other, over time and among industries. Unlike under IFRS 4, where it was difficult to see the key drivers of profitability, IFRS 17 reduces that challenge as now the key drivers of profits (investment vs underwriting) will become more transparent.

Moderate growth of 5.9% was recorded in the banking and investment segment in the first nine months of the year. Net results from this segment reached J$84.9 billion for the 9-month period when compared to J$80.1 billion in the prior year. While, the results from the segment over the first six months were relatively flat, they improved in the third quarter, driven by foreign exchange gains and fair value improvement on equity investments.

16-Aug-23	
Current price	69.70
Forcasted Dividend	2.91
Target price	81.85
Previous recommended price	N/A
TOTAL RETURN	21.60%

Company Data	
Outstanding shares	2,466,762,828
Market Cap	183,935,539,000
52-Week (Hi/Lo)	64.00/99.00
1Yr Daily Average Volume	350,128
5Yr Daily Average Volumes	424,113

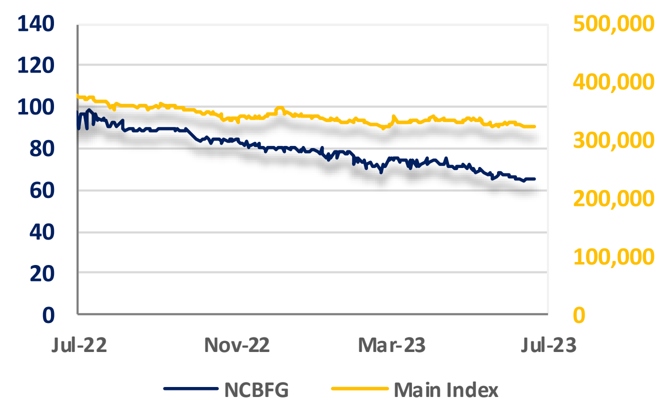
Major Shareholders	
AIC (Barbados) Limited	52.72%
MF&G Asset Management Linited - NCB Share Scheme	4.11%
Sagicor PIF Equity Fund	2.24%

Key Financials

J$ Bn	FY21	FY22	FY23e	FY24e
Net Operating Income	121.1	149.6	134.3	137.7
Operating Profit	26.3	45.1	33.6	37.2
Net Profit	20.1	39.9	27.4	32.2
Net Profit Change (%)	(0.3)	1.0	(0.3)	0.2
EPS	6.3	7.3	5.4	6.5
Dividend Yield	0.4%	0.0%	0.0%	2.7%

Price Performance

	1MTH	3MTH	1YR
NCBFG	7.0%	-2.2%	-43.4%
Main Index	-2.3%	-3.0%	-17.4%



Source: Bloomberg; JN Fund Managers Limited

ROE FY22 (X%)	ROA FY22 (%)	Non Performing Loan (%)	Capital to Risk Weighterd Assets (NCB)	Capital to Risk Weighterd Assets (NCBCapMrkts)	Liquidity Coverage Ratio (NCBJ)
17.6% +8.6%	2.0% +0.9%	4.4%x -1.7%	12.6% +0.1%	20.9% +0.50%	185.0% -46.4%
2021: 9.0%	2021: 1.1	2021: 6.1%	2021: 12.5%	2021: 20.4%	2021: 231.4%

Financial Overview

Revenues & Profitability Contd.

The banking and investment segment saw a continued rise in net fee and commission income driven by the Group's sustained robust growth in both its loans business and card transaction volume.

Net interest income expanded by 6.8% year to date. However, the Q3 results indicate that growth slowed during the third quarter as a result of rising rates, with the resulting higher cost of funding outpacing the income generated from loans. The banking and investment segment's results were also negatively impacted by increased credit impairment, likely reflecting the impact the high-interest rate environment had on its trading portfolio throughout the nine-month period. Management has evaluated and implemented measures aimed at aiding the Group in navigating the challenging high interest rate environment going forward. We will continue to assess these measures over the coming quarters.

The Group's operating expenses had a slight uptick of 2.1%, to J$78.9 billion in the period under review, when compared to nine-month 2022. Despite the reductions in depreciation and amortization charges, as well as decreases in professional and consultancy fees, these efforts proved inadequate to offset a notable 7.5% spike in staff costs, which arose from negotiated salary increases. Consequently, the Group's expense to NOI ratio deteriorated from 73.1% in nine-months of 2022 to 81.5% in the current period. The Group continues to seek ways to optimize its cost structure and expects that significant cost reductions will be delivered in subsequent periods.

Net profit, at J$13.7 billion over the nine-month period, fell short by J$12.2 billion when compared to the similar period in FY 2022. Consolidated net profits attributable to stockholders of the parent amounted to J$9.7 billion, or 47.9% lower than the J$18.6 billion reported in the similar period of the previous year. The reduction in NCBFG's profits resulted in a deterioration in several performance metrics, including eturn on Assets (ROA) and Return on Equity (ROE), which fell to 0.9% and 7.8% respectively, down from 1.8% and 16.1% respectively.

Balance Sheet

At the end of the third quarter (March 31, 2023), total assets for the Group climbed to J$2.2 trillion, driven by the growth in its loans and investment portfolios. The NCBFG's investment securities, inclusive of its pledged assets and reverse repurchase agreements, stood at J$1.1 trillion and remained the financial group's largest earning asset portfolio. Its loan book, net of provision for credit losses, stood at J$604.6 billion, up 4.1% on the amount reported at the end of FY 2022 (September 30, 2022). Non-performing loans (NPL) was J$24.9 billion at the end of the third quarter and lower than the J$25.9 billion reported at the end of the FY 2022.

Banking and Investing Activities – Net results from this segment increased by 5.9% despite the generally high interest rate environment and its negative impact on asset prices. This result was driven by improvements in net interest income, net fees and commission income and foreign exchange gains.

Moderate Growth in Deposits – The Group recorded a moderate (3.3%) growth in deposits Year to date (YTD) ending the period at J$731.1 billion. This is NCBFG's main source of funding and NCBJ remains number one among commercial banks, in terms of deposits held for its customers.

Operating Expenses – Operating expenses climbed to J$78.9 billion YTD, 2.1% above the amount generated over the similar period last year. Importantly, after the close of the third quarter (ended June 30, 2023), Management stated that they have already taken decisive actions which are expected to result in annual cost reductions (of ~J$6.0-$8.0 billion) and continue to seek ways to deliver further cost cuts. Additionally, over the last few years the Group made significant investments in transformational activities and technology which are projected to yield favourable results in the upcoming periods.

Loans and Advances – Loans and advances for the Group reached J$604.6 billion as at June 30, 2023. This was 4.1% higher than the amount reported at the end of FY 2022. Notably, this growth came even while non-performing loans declined. At the end of the nine month period, non-performing loans were J$24.9 billion, lower than the J$25.9 billion it reported at the end of its previous FY.

Earnings Per Share cut by almost 50% – NCBFG reported Net profits attributable to shareholders of J$9.7 billion for the period, which was 48.0% lower than the previous years figure. Consequently, EPS came in at J$4.22, almost 50% lower than the amount reported over the same period last year.

Risks to Monitor

COVID-19 – Notwithstanding the significant improvement, another variant of the virus outbreak may not only result in significant disruptions in the Group's activities but could also curtail economic growth, the Groups profitability and put further pressures on its resources.

Financial Overview

Balance Sheet Contd.

Following the decrease in non-performing loans (NPL), the Group's NPL ratio edged down to 4.0% from 4.4% at September 30 2022.

Growth in the Group's asset base, between the end of the last financial year (FY 2022) and June 30, 2023, was mainly funded by increases in other borrowed funds, obligations under securitisation arrangements and other liabilities. Total liabilities grew by 5.6% YTD reaching J$2.0 trillion at the end of the period. Equity attributable to stockholders of the parent was J$183.9 billion, having increased by J$34.4 billion or 23.0% over the first nine months of FY 2023. This was largely due to increase earnings and reduced unrealized fair value losses. It is expected that upon adoption of IFRS 17 at the start of FY 2024 the Group's previous financial statements will be restated. Anticipated adjustments indicate a potential decrease in equity, as profits previously accounted for in shareholders' equity upon contract inception are now subject to partial adjustments due to the incorporation of the contractual service margin (CSM) in accordance with IFRS 17.

As at the end of FY 2022, the Group continued to report adequate regulatory ratios.

Following an assessment conducted to ascertain the optimization of its capital, NCBFG undertook specific reclassifications on its balance sheets during the initial nine months of FY 2023. To that end, adjustments were made to certain assets within the banking group, resulting in savings in terms of capital utilization. This is particularly important, as the impending Basel III requirements are likely to test DTI's capital adequacy going forward. We will continue to monitor these developments in the coming periods.

Valuation Summary

1. **Relative Valuation Method (Summary)**

   Industry Average P/B = 1.31x
   NCBFG's Book Value = J$71.45
   P/B Valuation Est. = J$97.91

2. **DDM Valuation Method (Summary)**

   Required rate of return = 13.01%
   g = 5.60%, D_1=$2.91
   DDM Valuation Est. = J$65.70

NCBFG's Average Valuation Est. = $81.81

Risks to monitor cont.

Leadership Change - It is anticipated that there will be significant changes in the leadership at NCBFG this year. The Honourable Patrick Hylton and Dennis Cohen, who most recently served as Group Chief executive Officer (CEO) and Group Chief Financial Officer (CFO) /Deputy CEO of the NCBFG respectively, are expected to demit office after serving for over 19 years. We will continue to monitor these leadership changes and assess the impact risk, growth and cashflows going forward.

High Interest Rate – The current (relatively high) policy rate of 7.0% has increased the Group's cost of funding. As a result, this has compressed the spread it earns on its loans and has driven valuation lower on some of its assets. In the meantime, inflation has been trending down generally, and it is widely expected that the Bank of Jamaica (BOJ) policy rate will remain high for at least the next two to three quarters.

Slower Economic Growth – With the post pandemic boost to growth now fading, the Jamaican economy which advanced by 4.2% in the first quarter of CY 2023, is expected to slow further in the short to medium term. A significant slowdown in growth could lead to overall lower economic activity and slower top and bottom-line growth for the Group. However, Jamaica's relatively high levels of employment, Net International Reserves (NIR) and stable FX market could help to keep growth positive in the short run.

Basel III Implementation - The BOJ is currently implementing the Basel III capital requirements (Pillar 1) and has updated the regulatory capital definitions. The new requirements come as the banking regulator is of the view that the current capital and liquidity requirements are no longer aligned with widely observed international regulations. After the (current) period of parallel reporting is complete, the rules will become mandatory for Deposit Taking Institutions (DTI) . The new requirements will mean that DTIs must adhere to stricter capital rules, potentially prompting NCBJ to exercise greater caution in its lending practices, among other adjustments.

The Group may also be forced to hold relatively low-yielding, high-quality liquid assets. This is expected to reduce profitability as funds deployed to acquire these, may not always yield the highest possible return.
Essentially, these requirements may create fundamental growth challenges for banks, especially those seeking to increase their asset base. These requirements, while aimed at promoting sustainable growth, may lead to near-term slowdown as the full impact assessment may be slow in integrating into the product pricing mechanism.

Glossary of Terms

Asset Turnover ……………………… The asset turnover ratio measures how effectively a company uses its assets to generate revenue or sales.
Bank of Jamaica………………………... The Bank of Jamaica is the central bank of Jamaica located in Kingston. It was established by the Bank of Jamaica Act 1960 and was opened on May 1, 1961.
Contractual Service Margin (CSM)…… The contractual service margin (CSM) is a fundamental concept introduced by IFRS 17 is This represents the unearned profit that an entity expects to earn as it provides services.
Current Ratio ……………………… The current ratio (current assets/current liabilities) is a liquidity ratio that measures a company's ability to pay short-term obligations or those due within one year.
CY…………………………………... Calendar Year (January to December)
D_1……………………………… Next year's expected dividend
DTI – Deposit Taking Institutions ………Financial institutions that are authorized to accept deposits from customers and provide various banking services.
Efficiency Ratio ……………………….. The efficiency ratio shows expenses as a percentage of revenue (expenses/revenue). It essentially calculates how much a business spends to make a dollar.
FY……………………………………... Financial Year or Fiscal Year
Gross Margin ………………………… A profitability measure that looks at a company's gross profit compared to its revenue or sales, expressed as a percentage.
Leverage Ratio (Assets/Equity) ……… The Asset to Equity ratio is derived by dividing a company's total assets by its shareholders' equity. This ratio is an indicator of the leverage (debt) used to finance the company.
NIR - Net International Reserve ……... Net reserves are defined as that portion of the gross reserves attributable to MOST's interests after deducting royalties and interests owned by others.

NOI - Net Operating Income……......…Earnings reported by a bank or bank holding company, after deducting normal operating expenses, but before taking gains or losses from sale of securities, other losses and charge-offs, and additions to the reserve account for possible loan losses.
Net Profit Margin …………………….. Measures how much net income or profit is generated as a percentage of revenue.
NPL - Non-performing Loans ……….. Non-performing loans are loans as to which there have been no payments of principal or interest for 90 days or more.
Non-performing Loans (NPL) ratio ….. Non-performing loans as a percentage of gross loans and advances
QoQ - Quarter on Quarter ………… Used when comparing the financial performance between one quarter of one year to the same quarter of the previous year
Q1 …………………………………….. Quarter 1 or First quarter (usually of a company's financial year or country's fiscal year)
ROE - Return on Equity ……………… Return on Equity is a measure of financial performance calculated by dividing net income by shareholders' equity.
YoY - Year over Year ………………… Used to compare data or performance for a specific metric from one year to the same period in the previous year
YTD - Year to date …………………… The period of time from the beginning of the current calendar year up to the present date.