

# FDC Economic Bulletin

May 17, 2016

## *Equity Report : United Bank for Africa Plc (UBA)*

**Analysts Recommendation:** BUY

**Recommendation Period:** 365 days

**Target Price:** N5.31

### **Analyst's Note**

With oil prices still low despite slight recoveries in recent weeks, Nigeria's economy continues to go through turbulent times as creeping inflation, forex uncertainty, rising unemployment and bleak economic prospects persist. The banking industry is one sector that has fallen victim to the persistent macroeconomic headwinds that have weakened consumer purchasing powers and eroded earnings of companies including banks. Nigerian banks are grappling with reduced credit growth due to lower loan demand, higher impairments from oil & gas exposures, and increasing regulatory capital requirements. The Nigerian bourse All Share Index has lost over 12% YTD; just the banking sector index has declined 7.7% YTD. Various banks issued profit warnings prior to the release of their FY 2015 results.

In spite of all these adverse conditions, UBA has shown its resilience as reflected in ability to maintain profitability and ensure a high asset quality. Its PAT increased by 24.5% in FY 2015 and remained flat in Q1'16. The bank also maintained its non-performing loan ratio (NPL) at 1.7%, an industry benchmark. UBA's superior risk management framework helped ensure subdued impairment effects from oil & gas exposures. Its share price has declined by about 20% due to investor concern and pervading economic uncertainty. Given UBA's revenue potential, recent performance, extensive network and branch system, large customer base, robust risk management framework and exceptional management, it is a company with an immense upside. Accordingly, we place a BUY rating on the stock.

### **Profile**

UBA Plc is a leading African bank headquartered in Lagos, Nigeria with branches across Africa, Europe and America. UBA commenced operations as the British and French Bank Limited (BFB) in 1949 before it was incorporated as a limited liability company on 23 February 1961. Listed on the Nigerian Stock Exchange in 1970, it is the first Nigerian bank to make an Initial Public Offer and issue Global Depositary Receipts (GDRs).

Following its merger with Standard Trust Bank in 2005, UBA has pursued a pan-African expansion mission, which has seen it have branches in 19 African countries including Ghana, Kenya and Tanzania. The banking group provides corporate, commercial, SME, consumer finance and personal (retail) banking services to over 8 million customers through diverse channels including online banking, mobile banking, ATMs and social media.

UBA's growth through the years can be seen in key financial metrics between 2011 and 2015. During that period, total assets and shareholders (attributable to owners) have grown by a CAGR of 9.4% and 21.9%, respectively. Net interest income has also grown by a CAGR of 19.3% while net income grew by a CAGR of 5% between 2012 and 2015, after recording a loss in 2011.

United Bank for Africa (NGN'mn)	2011	2012	2013	2014	2015	CAGR
Gross loans to customers	605,627	658,922	937,620	1,071,859	1,036,637	14.4%
Net loans to customers	581,174	643,117	918,293	1,048,348	1,010,855	14.8%
Interest earning assets	1,670,982	1,880,732	2,169,212	2,155,756	2,237,635	7.6%
<b>Total assets</b>	<b>1,920,435</b>	<b>2,272,923</b>	<b>2,642,296</b>	<b>2,762,573</b>	<b>2,752,622</b>	9.4%
Deposit from customers	1,445,822	1,720,008	2,161,182	2,169,663	2,081,704	9.5%
Deposit from banks	19,510	57,780	60,582	59,228	61,066	33.0%
Interest bearing liabilities	1,602,372	1,892,308	2,270,630	2,342,688	2,272,666	9.1%
<b>Total liabilities</b>	<b>1,769,495</b>	<b>2,080,456</b>	<b>2,407,260</b>	<b>2,497,167</b>	<b>2,420,001</b>	8.1%
<b>Shareholders equity (attributable to owners)</b>	<b>147,345</b>	<b>189,106</b>	<b>227,647</b>	<b>259,930</b>	<b>325,827</b>	21.9%
Interest Income	113,590	150,003	185,700	196,680	233,969	19.8%
Interest expense	45,423	58,386	82,469	90,547	96,030	20.6%
Net interest income	68,167	91,617	103,231	106,133	137,939	19.3%
Net fee and commission income	38,660	45,108	44,874	47,966	53,335	8.4%
Profit before tax	(26,600)	52,010	56,058	56,200	68,454	NA
Taxation	(17,935)	533	9,457	8,293	8,800	NA
<b>Net profit</b>	<b>(8,665)</b>	<b>51,477</b>	<b>46,601</b>	<b>47,907</b>	<b>59,654</b>	5.0%

Source: UBA Plc Annual Reports

## Management

UBA's tremendous growth into becoming one of the dominant financial services institutions in Africa has been propelled by its driven and talented management team. Chaired by the visionary Mr. Tony Elumelu, the board of directors comprises accomplished professionals from varied sectors of the economy.

Mr. Elumelu is a renowned economist, investment guru, entrepreneur and philanthropist. He has been instrumental in turning UBA into one of the most successful pan-African banking hubs in Africa. In 2011, via his private holding company, Heirs Holdings, Mr. Elumelu was able to acquire conglomerate giant Transcorp. Beyond his business interests, Mr. Elumelu advises and holds seats in public and social sector boards such as the United Nations Sustainable Energy for All Initiative, Private Capital Group for Africa



## Who We Are

**A**vant-garde Academia Limited (AAL) is an education advisory and counseling service organization that was incorporated in July of 2013. AAL was incorporated as an educational aggregator in grooming candidates to be potential global citizens who will reinvest their acquired skills in Nigeria in future. It is positioned to provide support, assistance and guidance to potential candidates and entrants to Ivy League, Elite and premium academic institutions in America. Our target market comprises parents of children in identified elite Nigerian secondary schools and/or top executives in the business community, who have a strong need for our services.

The market also extends to Nigerians resident in Diaspora, and expatriates resident in Nigeria. In Partnership with Ascent Education Advisors, a reputable Education Advisory Services firm, we have designed a range of admissions solutions to cater for children in different stages of secondary school education.



### OUR STRATEGIC PARTNER – ASCENT EDUCATION ADVISORS

A reputable education advisory service firm, the lead consultant Ms. Peggy Hanefors has over 10 years experience in admissions; including a position as the Assistant Director of International and Transfer Admissions at the University of Pennsylvania. She was first reader and evaluator of about 3,000 applications for students from across the globe.

### What We Offer

- Information and advice about the American University System and its application process.
- Evaluation of student's record prior to application.
- Assistance in selecting curriculum and summer activities that will match the student's desired course of study and also highlight his/her personality and interests.
- Development of personal application timeline, that includes standardized testing, college visits, application deadlines, etc.
- Help in selecting teachers for recommendations
- Guidance in presenting extracurricular record
- Guidance in putting together an overall great college application that highlights the unique attributes of the applicant
  - Essay topic brainstorming
  - Editing
  - Proof-reading
- Guidance in choosing the most suitable college among acceptances.
- Interview preparation

### Our Packages

#### Package 1: 8th to 10th Grade (Final 3-5 Years)

This package is a program designed for candidates from as early as the 8<sup>th</sup> grade (Junior Secondary School - JSS 2) of high school. This is a full package with the benefits of all the services we offer in addition to education and assistance with entire college admission process, including an unlimited number of applications.

#### Package 2: 11th and 12th Grade (Final 1-2 Years)

This package is similar to Package 1 but is designed for students in the final two years of high school.

#### Package 3: (Per Application)

Unlike packages 1 and 2, package 3 only provides unlimited assistance with applications to pre-determined universities.

We host a Parents Admission Support Forum in Lagos bi-annually with the aim of giving parents the information they need to ensure their child(ren)/wards gain admission into reputable universities in United States of America.

To attend one of our events, kindly contact or visit us at 9a Idejo Street, Victoria Island Lagos.

For more information about Avant- Garde Academia Limited please go to our website: [www.avant-gardeacademia.com](http://www.avant-gardeacademia.com)

For enquiries or consultation E-mail us: [info@avant-gardeacademia.com](mailto:info@avant-gardeacademia.com) Or call Chinyere Ubani 08039238138 | Tope Vincent 08034017603

(PCGA) Partners Forum, and the Agricultural Transformation Implementation Council (ATIC). He serves as vice-chairman on the National Competitive Council of Nigeria (NCCN), is chairman at Transcorp, and co-chair at the Aspen Institute Dialogue Series on Global Food Security. Mr. Elumelu has two degrees in economics with a BA from the Ambrose Alli University and a Masters degree from the University of Lagos.

Phillips Oduoza currently serves as the Group Managing Director of UBA. Prior to this appointment, he was the Deputy Managing Director of UBA Plc responsible for banking business in the south of Nigeria. He is a banking veteran with a twenty-year banking career. He holds a first class degree in civil engineering and an MBA (finance), both from the University of Lagos. The renowned banker is an honorary fellow of the Chartered Institutes of Bankers.

Kennedy Uzoka is the Deputy Managing Director/ CEO of UBA Africa. He will take over from Phillip Oduoza as UBA's Group Managing Director in August 2016. His experience in managing UBA's African business positions him towards driving the company to achieve its next growth phase: being the leading financial services franchises in Africa. Mr Uzoka's career with UBA started with his supervision of the Bank's operations in New York and London. He headed the strategy and business transformation of UBA group before going on as regional bank head of the south bank of Nigeria covering over 17 states. With UBA he was also Regional Director, South East, Vice President, Northern Nigeria, Chief Marketing Officer, Federal Capital Territory (FCT), Chief Marketing Officer, Lagos, and later he served as Managing Executive Officer at STB (before merger with UBA). He holds a BSc in mechanical engineering from the University of Benin as well as an MBA from the University of Lagos.

With the abundance of high-performing professionals leading its evolution into becoming an African banking behemoth, UBA is positioned towards actualizing its immense potential even beyond Africa. The ability of UBA's management team to steer the bank towards profitability in both FY 2015 and Q1'2016 while managing its loan book risks, underscores the depth of its skilled management team.

## **The Bulls Say and the Bears Say**

### **Bulls Say:**

- Varied product range tailored to a diversified customer base
- Diversification of the Nigerian economy beyond the oil & gas sector provides banks with an opportunity to benefit from potential high-growth sectors
- Experienced and talented workforce
- Reduced risk of asset impairment as the bank's exposure to the oil & gas sector is below industry average
- Enhanced risk management framework
- Superior brand value

### Bears Say:

- Higher impairment risk due to exposures to the oil & gas and power sectors
- Persistent macroeconomic headwinds have reduced the bank's ability to grow its loan books and asset base
- Increasing regulatory requirements, which could negatively impact interest income and earnings
- Intense competition for customers and talent in the banking industry
- Customers are increasingly demanding for excellent service at lower cost

### Investment Thesis

FDC places a BUY recommendation on UBA Plc based on an analysis of the bank's interest earning potential, asset quality, rising interest rate environment, expansion strategy and favorable regulatory policies aimed at ensuring stability in the financial system. Though the downturn in the oil & gas sector has led many banks to impair loan assets belonging to oil & gas firms that have issued servicing their obligations, UBA's total oil & gas exposure of 19.2% has limited its asset write-offs on its loan books. Its non-performing loan (NPL) ratio of 1.7% is one of the lowest in the banking industry, and it underscores the bank's commitment to a sophisticated and enhanced risk management structure. Though more than half of UBA's oil & gas exposures are to the troubled upstream sector, they are to large international oil firms and a good number of the loans have been restructured.

Furthermore, with yields on government securities increasing due to the adoption of a tighter monetary policy, UBA stands to gain from its investment securities. Additionally, a possible hike of the MPR due to inflationary pressures would lead to a high interest rate environment, thereby positioning the bank to benefit through increased interest income. As the regulatory bodies become concerned about financial system stability, we expect less stringent regulations that could affect banking profitability. The introduction of the negotiable current account maintenance fee reflects the CBN's desire to maintain a stable financial system. This fee mitigates the loss of fee and commission income due to the implementation of zero commission on turnover (COT) fees. UBA's Q1'16 result shows an 11.2% increase in net fee and commission income. The combination of the economic and banking system factor, alongside the UBA's strategic expansion drive, shows that UBA is a company with a significant upside.

%	2016E	2017E	2018E	2019E	2020E
Net Interest Margin	6.1%	5.7%	5.9%	6.0%	5.6%
Gross Yield	10.3%	10.2%	10.2%	10.2%	9.8%
Cost of Funding	4.0%	4.3%	4.2%	4.2%	4.1%
RoAA	1.8%	1.8%	2.0%	2.2%	2.1%
RoAE	14.3%	14.3%	14.8%	15.8%	14.7%
Dividend Payout Ratio	27.3%	27.3%	27.3%	27.3%	27.3%
NPL Ratio	1.8%	1.7%	1.7%	1.7%	1.7%

# MHF PROPERTIES LIMITED

*"Where Quality Living Exceeds Expectations"*  
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www.mhfproperties.com

**FOR LEASE**

## MARIYA COURT

**Location:** 2B, Probyn Close, Ikoyi, Lagos

**Amenities:**

1. All rooms fitted with new air conditioners
2. Intercom system
3. Equipped kitchen with electrical cooker/oven, fridge, deep freezer and washing/drying machine.

**Other Facilities:**

1. Gym, squash court, steam bath, sauna, swimming pool with bar and barbeque stand
2. 24hrs power supply
3. 24hrs security/CCTV/Alarm system
4. 24hrs Technician on duty
5. Fully equipped play area for children



## RHAMA GARDEN

**Location:** 28, Gerard Road, Ikoyi, Lagos

**Amenities:**

1. All rooms fitted with new air conditioners
2. Intercom system
3. Equipped kitchen with electrical cooker/oven, fridge, deep freezer and washing/drying machine.

**Other Facilities:**

1. Gym, squash court, steam bath, sauna, swimming pool with bar and barbeque stand
2. 24hrs power supply
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## Valuation

We derived our valuation for United Bank for Africa Plc using the dividend discount model (DDM) method. Our fair value estimate for UBA Plc is **N5.31**, which is a 56.2% upside on its current share price of N3.40 as at 09 May, 2016. The discount rate used in the DDM is the cost of equity (20.7%), which is computed via the capital asset pricing model (CAPM). The terminal P/BV, which is factored into calculating for exit multiple, was derived using the formula  $(\text{Return on Equity (ROE)} - \text{Net Income Growth}) / (\text{Cost of Equity} - \text{Net Income Growth})$ . The intuition behind using this formula is considering how much of UBA's ROE is being allocated to grow dividends and how much does it cost. Based on this intrinsic valuation, UBA is an undervalued stock with a potential for significant appreciation.

In forecasting UBA's assets and earnings, we took into account the low oil price environment, possible devaluation and the overall macroeconomic condition. These issues, alongside Nigeria's monetary policy uncertainty, are major investor concerns.

United Bank for Africa Plc					
NGNm	2016E	2017E	2018E	2019E	2020E
Dividends	13,658	15,240	17,629	21,088	21,952
Discount period	1	2	3	4	5
PV of Dividends	11,320	10,470	10,038	9,952	8,587
Equity	369,785	411,255	459,224	516,604	576,336
<b>Terminal Value:</b>					
Terminal P/BV	0.64				
Terminal Value (Exit Multiple)	369,993				
PV of Terminal Value	144,730				
PV of Dividends	50,367				
Present Value (NGNm)	195,097				
Shares outstanding (mn)	36,729				
<b>Share price (NGN)</b>	<b>5.31</b>				

## Risk

The major risks facing UBA include higher impairments due to weaker economic prospects, reduction in interest and non-interest revenues, possible devaluation and forex uncertainty, adverse regulatory requirements and increased investor concern. These risk factors could potentially reduce UBA's earnings, deteriorate its asset quality and lead to a plunge in share prices.

Persistently low oil prices could lead to a further impairment of UBA's oil & gas loans. Besides its impact on oil & gas companies, the low oil price regime has impeded economic growth, thereby hampering banks' ability to grow loans. UBA also has one of the highest exposures to the power sector (9.8%). The power sector is having issues due the use of foreign exchange in acquiring the power companies and assets. These transactions were funded mainly by banks, and the loans to these power firms may have to be impaired,

especially with a currency adjustment looming. Furthermore, some stifling regulations such as the revision of Basel 2 guidelines and a possible review of certain fees, could strain the bank's capital structure and its revenue base.

While these risks pose a challenge to the bank's revenue and profitability, the bank's management team has shown that it has the appropriate risk management structure to handle adverse economic conditions. The quality of UBA's loan asset and its solid NPL ratio are impressive. The bank's capital adequacy ratio (CAR) of 20% and its Tier 1 ratio of 16% indicate adequate capital buffer. Furthermore, with oil prices recovering and projected to average at over \$50 by year end, there is a possibility of reduced impairment of oil & gas loan assets. A recovery in economic growth would also boost investor confidence. In sum, UBA is well-placed to withstand shocks arising from the overall economy or banking industry.

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