INVESTMENT AND SOVEREIGN RESEARCH *December-7-2023*

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NCB Financial Group Limited

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Executive Summary

NCB Financial Group Limited (NCBFG) is a firm incorporated and domiciled in Jamaica, with a majority stake of 51.15% held by AIC (Barbados) Limited. The principal parent corporation of AIC is Portland Holdings Inc., which resides in Canada. Hon. Michael A. Lee-Chin, OJ, is the controlling authority of Portland Holdings Inc., and he also holds the position of Chairman at NCBFG. Presently, the company operates in numerous territories including Jamaica, Cayman Islands, Trinidad & Tobago, Barbados, Bermuda and the United Kingdom, along with various other countries via its subsidiary Guardian Holdings Limited (GHL). NCBFG directly controls four subsidiaries: National Commercial Bank Jamaica (NCBJ), Clarien Group Limited (Clarien), NCB Global Holdings Limited, and TFOB.

The Net Operating Income (NOI) of NCBFG saw growth with a CAGR of 10.8% throughout the period under review (FYE September 2019 - FYE September 2023), reaching $137.3 billion. On the flip side, there was considerable fluctuation in the net profit attributable to shareholders during the same period, hitting a high of $29.9 billion in FYE September 2019, but dropping to a low of $7.6 billion in FYE September 2023. Concurrently, there has been a steady rise in total assets over this period, propelled by similar growth patterns in customer deposits.

NCBFG is presently trading at a trailing twelve-month (TTM) earnings per share (EPS) of 20.9x, which is considerably higher than the average of its peer group, pegged at 9.8x. In relation to the current trading volumes of other listed companies, NCBFG's stock exhibits a comparably high level of liquidity, with an average daily value of $23.1 million traded over the past year. In the last month, NCBFG has seen an average bid-ask spread of 2.3%, signifying a relatively low implicit cost associated with trading its shares.

Recommendation: MARKETWEIGHT

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Key Financial Data

	YE 2019	YE 2020	YE 2021	YE 2022	YE 2023	CAGR
BVPS	59.83	63.29	65.45	60.62	69.06	3.7%
Trailing EPS	12.11	8.01	6.25	10.39	3.30	-27.7%
Dividend Per Share	3.40	1.90	0.50	0.00	0.00	-100.0%
Price Per Share	208.79	130.90	127.52	89.89	68.49	-24.3%
JSE Main Market	516,043	380,426	414,890	361,692	327,042	-10.8%
Abridged Income Statement (in Billions)						
Net Operating Income	91.18	108.83	121.11	145.31	137.3	10.8%
Net Interest Income	44.60	52.49	48.63	59.20	62.8	8.9%
Gain on FX & Investment Activities	15.41	8.79	22.83	16.58	20.2	7.1%
Net Revenue from B&I Activities	76.7	76.4	98.2	107.3	113.0	10.2%
Net result from Insurance Activities	14.43	32.46	22.95	38.02	24.2	13.8%
Staff costs	32.12	40.53	44.50	50.34	60.6	17.2%
Other operating expenses	25.67	31.10	39.20	44.41	47.5	16.6%
Operating Profit	26.44	27.26	26.26	39.62	19.6	-7.2%
NCBFG Shareholders Profits	29.87	19.09	14.23	23.89	7.6	-29.0%
Abridged Balance Sheet (in Billions)						
Total Assets	1,616.30	1,800.26	1,921.40	2,080.52	2,225.3	8.3%
Loans	423.10	452.95	523.49	580.99	613.8	9.7%
Investment Securities	386.19	456.80	683.86	711.73	825.7	20.9%
Customer deposits	504.68	573.97	647.09	715.28	747.9	10.3%
Other borrowed funds	124.95	125.07	136.97	153.27	179.7	9.5%
Total Liabilities	1,432.43	1,600.06	1,714.70	1,882.52	2,001.5	8.7%
Equity	147.59	156.11	161.46	149.53	170.4	3.7%
Ratios						**Average**
P/E	17.2	16.3	20.4	8.7	20.8	16.7
P/B	3.5	2.1	1.9	1.5	1.0	2.0
Dividend Yield	2.10%	1.14%	0.36%	0.00%	0.00%	0.7%
Dividend Payout Ratio	28.08%	23.72%	8.00%	0.00%	0.00%	12.0%
NII Margin	68.54%	70.53%	65.21%	69.71%	62.00%	67.2%
Cost to Income	67.4%	68.5%	76.2%	71.4%	82.5%	73.2%
ROE	21.5%	12.6%	9.0%	15.4%	4.7%	12.6%
ROA	2.3%	1.1%	0.8%	1.2%	0.4%	1.1%
Debt to Equity	0.8	0.8	0.8	1.0	1.1	0.9
Financial Leverage	8.0	8.9	9.1	9.9	10.2	9.2
Stock Price Performance	67.7%	-37.3%	-2.6%	-29.5%	-23.8%	(0.1)
JSE Main Market Performance	44.0%	-26.3%	9.1%	-12.8%	-9.6%	0.0

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Financial Overview

Income Statement Review

In the review period, NCBFG's net operating income (NOI) experienced a compounded annual growth rate (CAGR) of 10.8%, culminating in a total of $137.3 billion. However, in the financial year ending (FYE) September 2023, there was a contraction in NOI by 5.5%, equivalent to $8 billion, falling short of the CAGR for the review period. This downturn in NOI was primarily triggered by a slump of 36.3% in net results from Insurance activities, which stood at $24.2 billion. The primary catalyst for this decline was a surge in insurance benefits and claims by 12.8% to $78 billion. This escalation in insurance benefits claims can be attributed to an upswing in elective surgeries that had been deferred due to the COVID-19 pandemic.

During the financial year ending in (FYE) September 2023, the net revenue from B&I activities witnessed a rise of 5.3%, reaching $113 billion. This revenue expansion was primarily due to a 6.1% surge in net interest income (NII), which amounted to $62.8 billion. The elevation in NII can be attributed to a significant 19.3% increase in total interest income but constrained by a substantial rise of 49.6% in interest expenses. The NII growth was propelled by an expansion in loans and investment securities portfolios as well as higher yields on certain interest-bearing assets. Moreover, the B&I activities growth was supported by a notable 22.1% increase in gains from foreign exchange and investment activities, amounting to $20.2 billion. The gains from investment activities received positive impact due to unrealised fair value gains on equity investments that were designated as fair value through profit and loss.

In the financial year ending September 2023, credit impairment provisions witnessed an upsurge of 95%, reaching a total of $5.3 billion. However, it is crucial to note that this amount represents only about 0.9% of net loans as of the conclusion of FYE September 2023. This increase aligns with historical trends, which averaged around 1.1%. The sharp rise in provisions is primarily attributable to the previous year (FYE September 2022) having figures below average due to the inclusion of ECL charge reversals brought about by an enhanced economic forecast.

For NCBFG, the financial year ending in September 2023 saw a rise of 11.3% in operational expenses, marking the slowest rate of increase throughout the period under review. The principal driver of this surge in operating expenditure was a notable 20.4% escalation in personnel-related costs. This surge in staff expenses can primarily be attributed to crucial changes in leadership and other key roles, leading to costs associated with restructuring and separation. The combination of an increase in operating expenditure and a decrease in Net Operating Income (NOI) are the main contributors to a steep decline of 68.2% in profit, amounting to $7.6 billion.

Balance Sheet Review

During the period under review, the group's total assets exhibited a steady ascension, registering a CAGR of 8.3%, reaching an apex of $2.2 trillion at the close of FYE September 2023. However, the expansion pace of total assets slightly decelerated to 7% in FYE September 2023. This escalation was principally fuelled by a 16% surge in investment securities. The main elements comprising NCBFG's total assets were loans, investment securities, and pledged assets, representing 27.6%, 37.1% and 12.8% respectively.

Investment securities have consistently been the highest contributors to total assets, escalating at a CAGR of 20.9% throughout the reviewed period. However, the expansion pace of investment securities decelerated to 16% in the financial year ending September 2023, culminating at $825.7 billion. The surge in investment securities for FYE September 2023 was facilitated by enhancements in asset prices and portfolio growth.

Net loans have also consistently increased over the review period at a CAGR of 9.7%. In FYE September 2023, net loans saw an increase of 5.6% to $613.8 billion a slower pace than the review period. Additionally, non-performing loans totalled $25.7 billion at the end of FYE September 2023 a marginal decline from the the similar period the prior financial year. This resulted in non-performing loan ratio decreasing to 4.1% from 4.4% in the prior year.

During the assessment period, equity attributable to NCBFG shareholders witnessed a CAGR growth of 3.7%, culminating at $170.4 billion. However, the financial year end September 2023 experienced an impressive equity increase of 13.9%, notably exceeding the CAGR during the review period. The fair value and capital reserves shifted from a deficit of $26.9 billion in FYE September 2022 to a deficit of $9.4 billion, marking a considerable swing of $17.5 billion by the close of FYE September 2023. The predominant reason for this rise was an enhancement in asset prices.

The major elements of NCBFG's liabilities are customer deposits and commitments under insurance and annuity contracts. Over the period under review, customer deposits have demonstrated steady growth, registering a CAGR of 10.3%, although this notably decelerated to 4.6% in FYE September 2023. These deposits represent a substantial portion of the Company's liabilities, corresponding to 33.6% of total assets, and function as a principal funding source for the group's activities. Simultaneously, liabilities relating to annuity and insurance contracts also comprise a substantial fraction of total assets, equating to 20.7% in FYE September 2023. The bulk of these liabilities take the form of life and health insurance as well as annuity contracts.

Ratios Review

During the time under scrutiny, the company's Net Interest Income Margin (NII Margin) averaged at 67.2% and reached its zenith in the financial year ending September 2020 at 70.5%. However, a drop to a period low of 62% was seen by the financial year ending September 2023. This significant reduction is predominantly due to a surge in finance costs of about 49.6%, which greatly overshadowed the growth in interest income. The noticeable upswing in interest expenditure is partly a result of the current interest rate climate, leading to increased funding costs at the institution.

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During the evaluation period, the average cost to income ratio stood at 73.2%, reaching a high of 82.5% in the financial year ending September 2023. This surge in the cost to income ratio can be partly attributed to a substantial rise in expenses in Q4 of FYE September 2023, a result of the considerable costs associated with leadership alterations and other modifications, leading to restructuring and separation expenditures.

The Return on Average Equity (ROAE) has shown considerable fluctuation over the period of review, reaching a high point of 21.5% in FYE September 2019. This unusually high ROAE resulted from several unique gains, including profit from partial disposals of an associate and a subsidiary. However, in the most recent financial year, the ROAE reached a low point for the review period at 4.7%. The decrease can be attributed to higher expenses related to several one-off items.

During the period under analysis, the company's debt to equity ratio has generally exhibited an upward trajectory, reaching a peak of 1.1x at the conclusion of the financial year ending (FYE) September 2023. The debt component used for these calculations is primarily constituted by the 'other borrowed funds' line item, predominantly comprising corporate notes. The financial leverage demonstrated a similar pattern, reaching its zenith at 10.2x at the close of FYE September 2023.

Forecast and Valuation

We have established a price target for NCBFG at $87.70, which we derived by applying the harmonic P/B and P/E multiples of the peer group to our projected BVPS and EPS for NCBFG in FY 24. This computation took into account the historical disparities that are typically associated with the difference in valuation between NCBFG and its peer group. Our projection is based on the assumption that the investor sentiment towards the peer group will remain fairly stable. Below, we've included diagrams demonstrating how NCBFG's P/B and P/E ratios compare to those of the peer group over the previous three years. **By employing the 85th and 15th percentile of the P/B and P/E valuation discrepancy, we determined our maximum and minimum price objectives, which are $111.84 and $63.30 respectively**.

	Price Target	Implied Upside/(Downside)
Upper	111.84	▲ 62.5%
Base	87.70	▲ 27.4%
Lower	63.30	▼-8.0%

As depicted in **Chart 1**, the P/B ratio for NCBFG is presently trading at a 9.2% discount when compared to its peer group. Historically in the past three years, NCBFG's shares have been seen to trade on average at a premium of 15.8% relative to the P/B ratio of its peer group. This indicates that currently, NCBFG's shares are uncharacteristically inexpensive in relation to its peers when assessed on a P/B basis.

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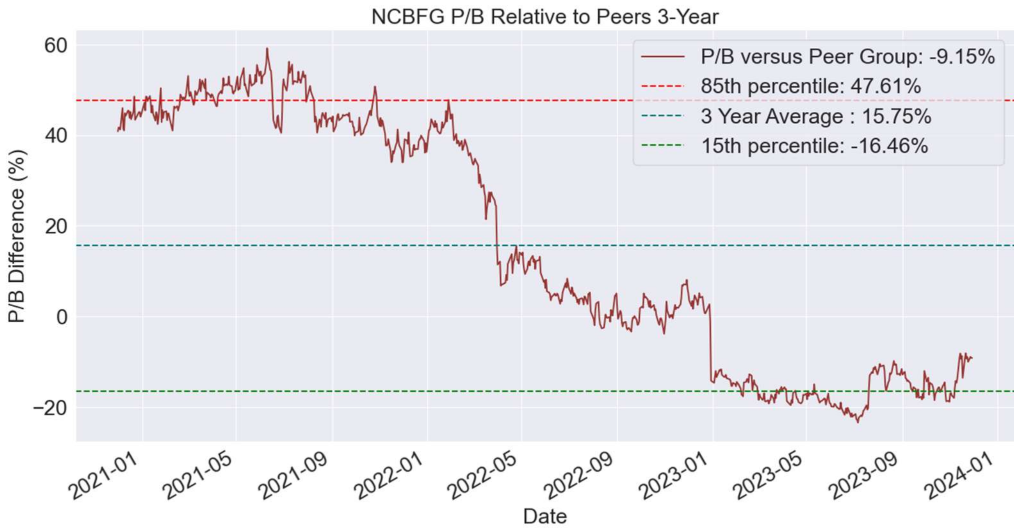
Chart 1.



As demonstrated in **Chart 2**, the P/E ratio of NCBFG is notably higher than that of its peer group. Traditionally, over the previous three years, NCBFG shares have traded at an average premium of 32% compared to the P/E ratio of its peers. This suggests that the current premium for NCBFG is significantly above historical patterns, due to a substantial drop in earnings for FYE September 2023. As previously mentioned in this report, this decrease can be largely attributed to a material loss in Q4 FYE September 2023 because of several non-recurring items. Consequently, we anticipate this significant deviation from historical standards to return to normal levels as time advances.

Chart 2.

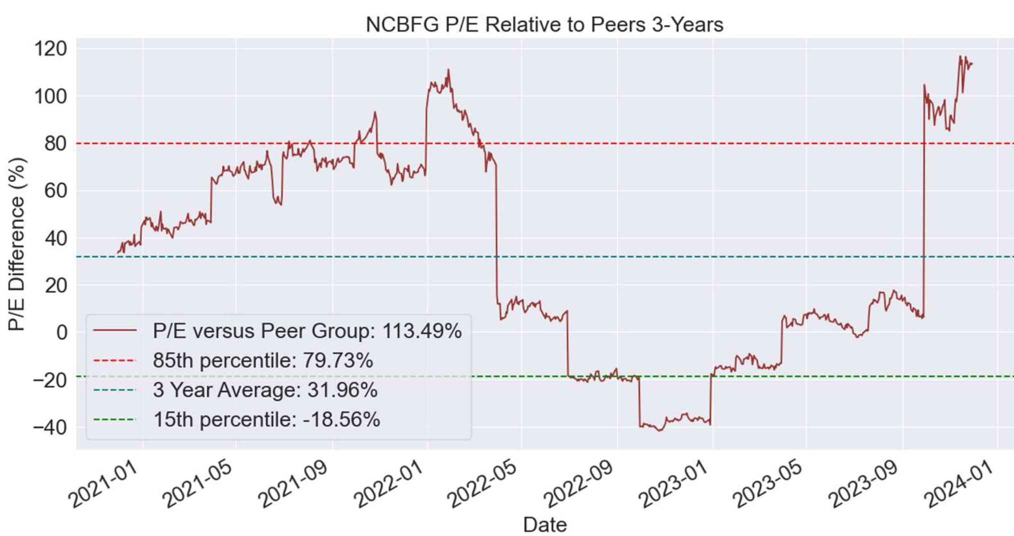


Chart 3 explicitly portrays a significant degeneration in the P/B ratio of NCBFG over time. In the calendar year 2019, NCBFG's P/B ratio reached an apex of nearly 3x. Nevertheless, following this zenith, there has been a rapid decline noted, leading to a present five-year average of 2.11x. The prevailing P/B ratio is at a 1.0x, which is the nadir since the calendar year 2017.

Chart 3.

As depicted in **Chart 4**, the P/E ratio for NCBFG has exhibited significant variability. This has been influenced largely by considerable one-off costs and gains realised from the sale of associated companies. At present, the trailing P/E stands at approximately 20.9x, which is significantly above the 5-year historical average of about 15.2x. Nonetheless, it is important to recognise that extraordinary losses have influenced a increase in the current trailing P/E of NCBFG by lowering trailing EPS.

Chart 4.

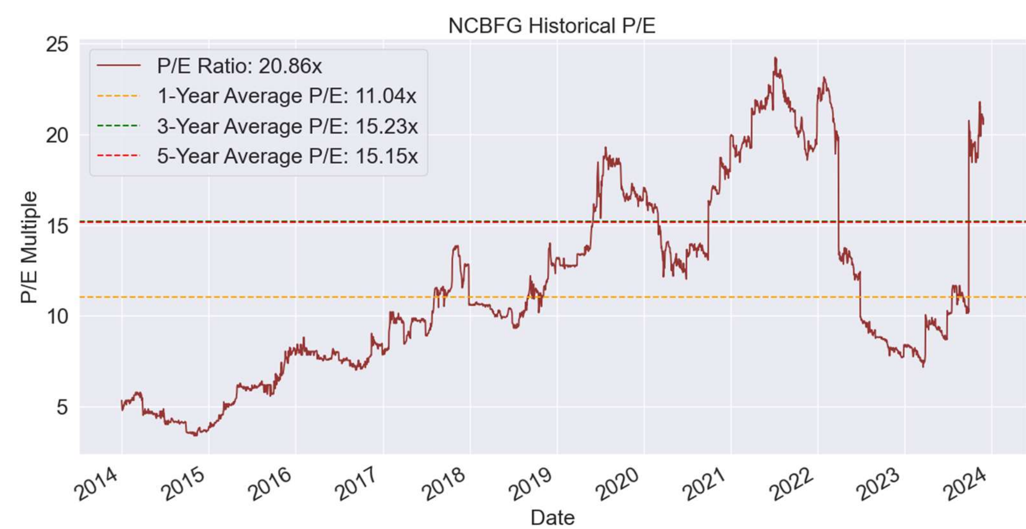


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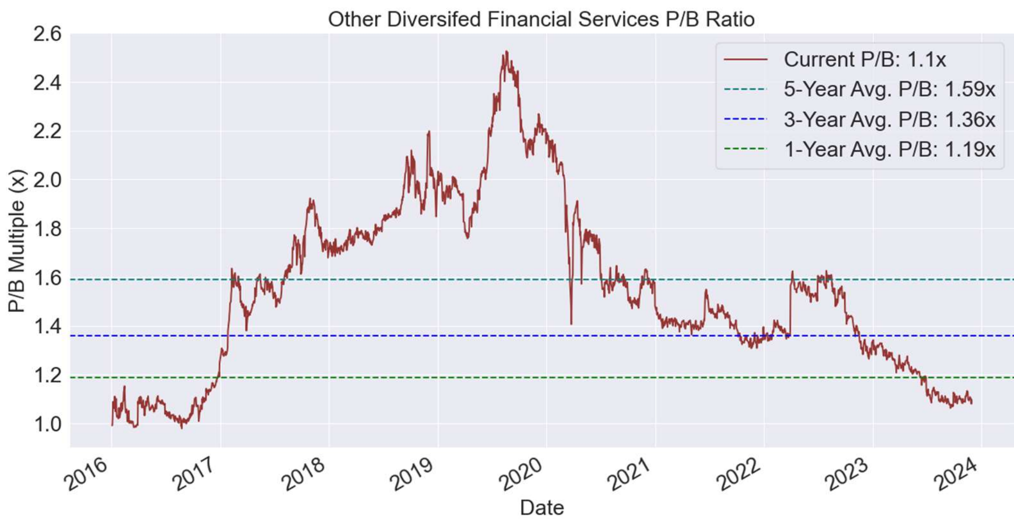
Chart 5 illustrates a significant contraction in the P/B ratio of the peer group, plummeting dramatically from above 2x in the calendar year 2019 to its current standing at approximately 1.1x. The five, three, and one-year average P/B ratios reveal a pattern of dwindling averages, indicating a persistent downward path for P/B. The market experienced a steep drop in P/B owing to the COVID-19 sell-off, reaching around 1.4x early in the calendar year 2020. However, after a rapid bounce back, it has since declined significantly. The current P/B of about 1.1x aligns with levels previously seen in the calendar year 2017. The abrupt rise in policy rates starting from October 2021 has contributed to depressed multiples across the peer group. It is important to note though that the reduction in P/B multiples started before interest rate increases and negative COVID-19 impacts, implying an aspect of over-enthusiasm within the market preceding these major events.

Chart 5.



As illustrated in **Chart 6**, NCBFG has underperformed relative to the Main Market Year-To-Date (YTD), exhibiting a decrease of approximately 13.9% as opposed to the Main Market's fall of 12%. The latest announcement of a significant drop in Q4 earnings for the year ending September 2023 elicited a rather subdued reaction from investors. This may be due to the earnings drop being anticipated by the market beforehand, owing to one-off expenses. Additionally, an improved performance is likely anticipated by investors in future.

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Chart 6.

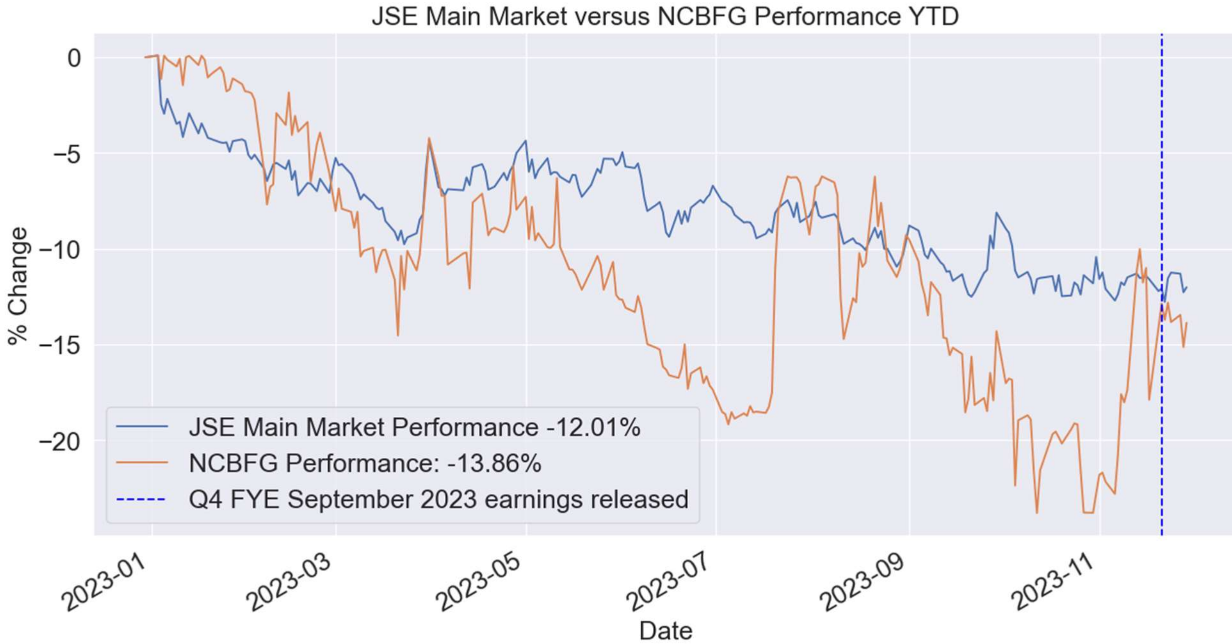

Chart 7 delineates the month-on-month and annual performance of NCBFG across a multitude of periods. In the calendar year 2022, the company endured its worst performance, with a slump of 35.7%, while its most impressive achievement was in 2015, when it registered a substantial growth of 116.2%. A consistent decline in NCBFG's shares was witnessed from the calendar year 2020 to 2022. Moreover, it seems likely that NCBFG is poised for further depreciation in share value for the calendar year 2023. Nevertheless, it's worth noting that from calendar year 2014 to 2019, NCBFG rewarded shareholders with consistent growth in share price. During these years, although earnings mostly demonstrated a growing trajectory, there was a slight dip in the financial year ending (FYE) September 2017. Despite recording growth in earnings for FYE September 2019, this was inflated by gains from divestment of associated companies and investments which only provided temporary bolstering to earnings.

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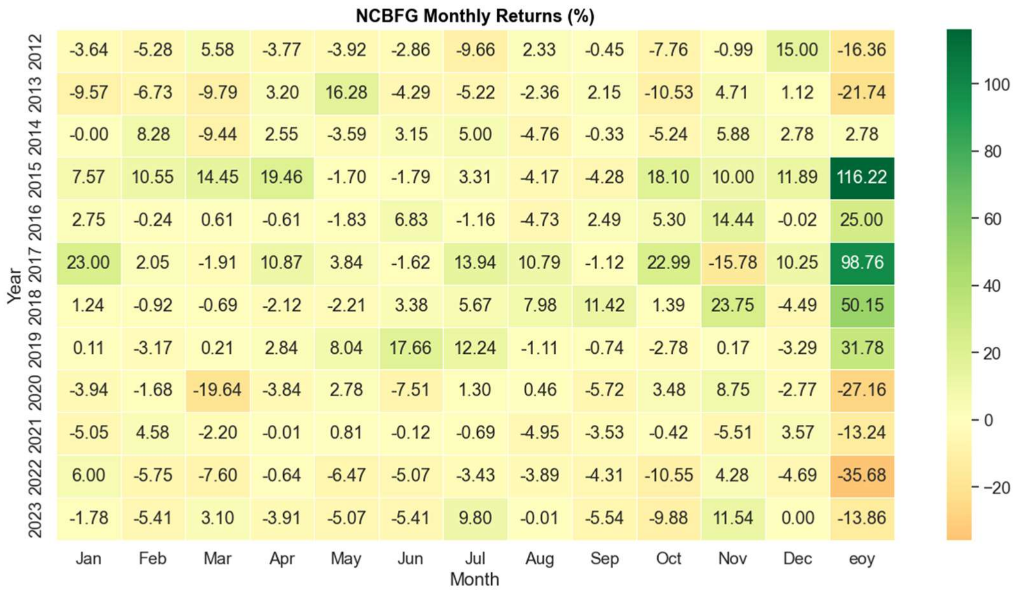
Chart 7



The current bid-ask spread for NCBFG is presently at 2.3%, a slight increase from the preceding year's average of roughly 2% as illustrated in *chart 8*. The bid-ask spread for the previous month was also marked at 2.3%, suggesting that the implicit trading cost for the company's shares is typically relatively low.

Chart 8

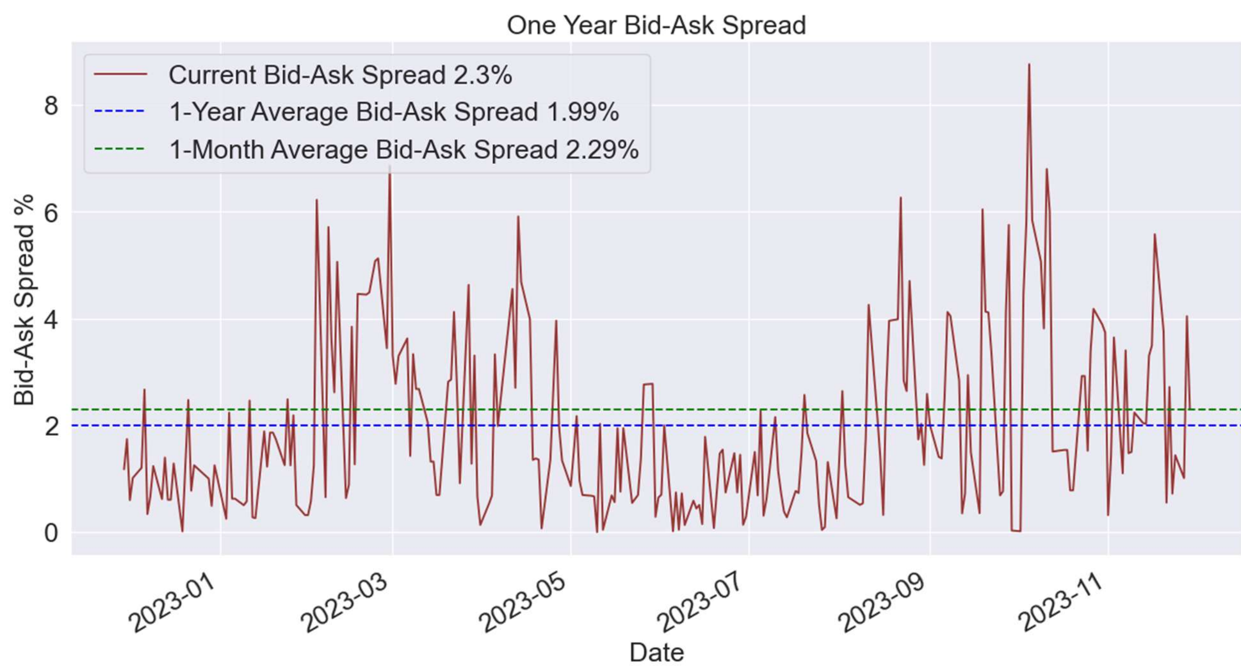


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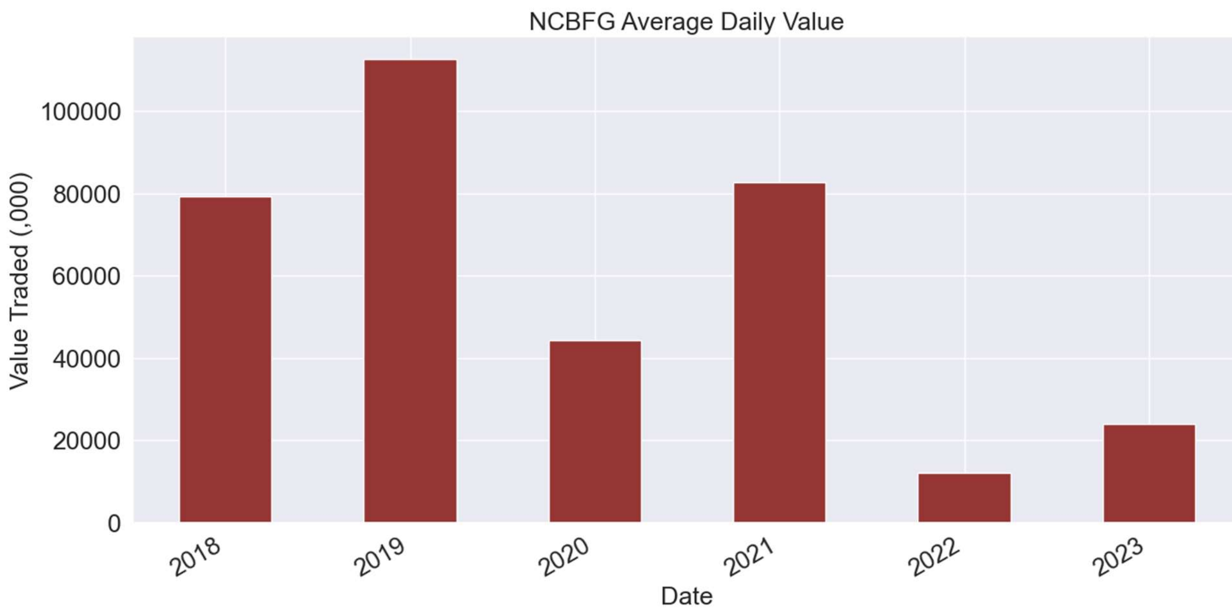
Chart 9 provides a visual representation of the average daily trading value transacted on NCBFG from the calendar year 2018 through to the calendar year 2023, as displayed by bar graphs. The peak was witnessed during the calendar year 2019, where an average daily value soared above $112.5 million. On the contrary, for the current YTD, there has been a substantial plunge in the stock's average daily trading value to a mere $23.9 million, which is considerably lower than what was observed in calendar year 2019. This decline is consistent with the wider market activity. During January and October of calendar year 2019, transactions on the Main Market amounted to roughly $78.9 billion in value. This stands in stark contrast to a significantly reduced figure of $26.4 billion during the same period in calendar year 2023 - signifying a reduction by two-thirds or 66.5%.

Chart 9



Outlook

The board of directors has announced a dividend payment of $0.50 to be distributed on the 18th of December, 2023 to shareholders registered by the 4th of December, 2023. This marks a return to dividend payments following a similar distribution in May 2021. The NCBFG chairman has also asserted the importance of regular dividends. Consequently, we anticipate an elevated probability of future dividend distributions.

In the fourth quarter of the FYE September 2023, NCBFG saw a considerable rise in expenditures. These are anticipated to curtail costs for the subsequent years starting from FYE September 2024. This sets the company on a path towards significantly improved profitability, even under conditions of moderate revenue growth.

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In the most recent investor briefing by NCBFG, the company disclosed that upon adjusting its non-recurring expenses for the financial year ending September 2023, such as staff separations, the profits would have been in the region of $20 billion. This forms a plausible basis for predicting earnings for FYE September 2024 and beyond. The company further revealed that it anticipates an annual saving of roughly $8 billion due to various cost reduction strategies already put into action.

During a recent Extraordinary General Meeting, shareholders of NCBFG have sanctioned the potential issuance of an additional 300 million new shares, with a discretionary upsize option of an extra 150 million shares. The intent behind this issuance is to provide robust support to the firm's balance sheet and facilitate future growth opportunities. However, Mr. Robert Almeida, the Interim CEO of NCBFG, has stated that the company will release these new shares in quantities and at prices that achieve a balance between meeting the company's requirements while reducing dilution for its existing shareholders. Moreover, it was suggested that the capital raised could be channelled towards debt reduction within the company, potentially boosting earnings and dividend growth.

Hence, significant risks to our price target comprise cost reduction not achieving our projected levels. In addition, a persistent decrease in the multiples of the peer group due to deteriorating investor sentiment could also pose a risk. A blend of these elements could lead to NCBFG's share price not reaching our anticipated levels.

FY	Q1	Q2	Q3	Q4	YE
2024	1.64E	2.74E	3.77E	2.64E	10.79E
2023	0.36E	1.48E	2.38E	-0.92E	3.30E

Recommendation

We are assigning a **MARKETWEIGHT** rating to NCBFG. The equity is trading above the base of our price target scope but beneath our specified price target of $87.70. Our recommendation takes into account the robustness of NCBFG's balance sheet, recurrence of consistent dividend disbursements and improved stability in profitability, as well as the share liquidity of NCBFG in comparison to other publicly traded entities.

In the period under review, we have observed steady growth in revenues originating from multiple regions and various business divisions. However, the unpredictability in earnings throughout the same period slightly dampens our enthusiasm. Furthermore, the escalating interest expenses could potentially restrict the growth of net interest income, which may subsequently impede the advancement of Net Operating Income in FYE September 2024.

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Prior to the recent halt in dividend disbursements, the firm demonstrated a consistent trend of incrementally elevating dividend payments. Should the corporation resume this pattern, it would likely foster heightened investor confidence towards the company. The recently disclosed tactics are anticipated to be effective in restoring the reliability of dividends.

We perceive the issuance of additional shares as a net positive, providing it aligns with the senior management's prescribed guidelines. Furthermore, utilising the proceeds to diminish debt could contribute towards boosting profitability and easing financial leverage, potentially enhancing dividend payouts further.

The firm's total assets have witnessed a steady surge throughout the period under review, mirroring the trend seen in customer deposits. This is a positive indicator for the long-term growth of revenues. On another note, although the growth of equity within the company has mostly been on an upward trajectory, it experienced a downturn in FYE September 2022 due to depreciating asset values. This underscores the necessity for the firm to uphold substantial capital levels.

In the near future, we anticipate a rise in earnings for the financial year ending September 2024, driven by cost containment and slight growth in revenue. This is attributed to the steps taken towards cost reduction in the financial year ending September 2023. Furthermore, we foresee a modest increase in revenue, with substantial enhancements in the insurance segment as costs standardise and the effects of cost-cutting methods become more noticeable.

Our projections for the financial year ending in September 2024, based on the current price of NCBFG, suggest a forward P/E ratio of 6.4x. This figure harks back to levels last observed in the calendar year of 2015. This is quite a prudent estimate, considering that NCBFG posted an EPS of $10.39 in FYE September 2022 and the downsizing of costs bolsters the prospects for growth in the company's profits.

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/STRONGLY 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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