Barita
MAKING MONEY WORK FOR YOU.

LOCAL EQUITY REPORT

NCB FINANCIAL GROUP LIMITED

Barita Investments Limited
15 St. Lucia Way, Kingston
Tel #: 1-888-429-5333

Company Overview

NCB Financial Group Limited (NCBFG) is a Jamaican-based holding company that holds the largest commercial bank in Jamaica by assets and profits, NCB Bank Jamaica. The primary business of the group and its subsidiaries comprise commercial banking, life & general insurance, and wealth & investment management activities. Its major subsidiaries include National Commercial Bank Jamaica Limited, NCB Capital Markets Limited, NCB Insurance Company Limited, Guardian Life Holdings, and Clarien Bank Limited. Some of NCBFG's associate companies include RGM Limited with 33.3% and Elite Diagnostic with 18.7% among others. Currently, NCBFG is 52.68% owned by AIC (Barbados) Limited with the ultimate parent being Portland Holdings Inc which is incorporated in Canada and controlled by the chairman of NCBFG, Michael Lee-Chin.

Stock	NCBFG
Last Closing	J$67.95
52 Week High	J$105.00
52 Week Low	J$67.00
YTD Return	-14.98%
Trailing P/B	0.97X
Trailing P/E	7.54x
Forward P/E	6.99x
Target Price	J$84.33
Upside Potential	24.1%
Recommendation	OVERWEIGHT
Date	June 9, 2023

Investment Summary and Rationale

NCBFG has been challenged due to the macroeconomic environment in recent quarters, namely the shift to a more restrictive monetary policy that has challenged its capital position. This has necessitated management's focus on liquidity and thus the decision to forego dividends for an extended period. These factors in conjunction with the general decline in the overall market and a specific weakening sentiment for financial sector stocks in general have negatively impacted the price performance of the group. While we don't foresee a return to dividends in the short term and there might also be continued headwinds as it relates to its insurance segment, we do expect that the general macroeconomic environment will improve, particularly as we head towards the peak of the current hiking cycle.

Given the above, we expect to see a modest recovery in the group's capital and liquidity position over the coming year, even as we expect earning growth to continue to be subdued relative to prior years. We still believe that due in part to the current negative sentiment, the stock is priced attractively as we enter the new macroeconomic cycle. Hence, we believe the investor with a long-run focus and a want for a relatively more liquid blue chip holding might consider being OVERWEIGHT in NCBFG with a price target of $84.33. The major downside to this recommendation is however the expectation of no dividends within the next year, which may not only deter investors that want that additional liquid income but may also delay the recovery of market sentiment in the stock.

Therefore, the stock is most suitable for investors looking for a beaten down "blue chip" trading relatively cheap compared to fundamentals with no immediate need for dividends income and an outlook long enough to weather continued short-term negative sentiment.

Industry Overview and Outlook

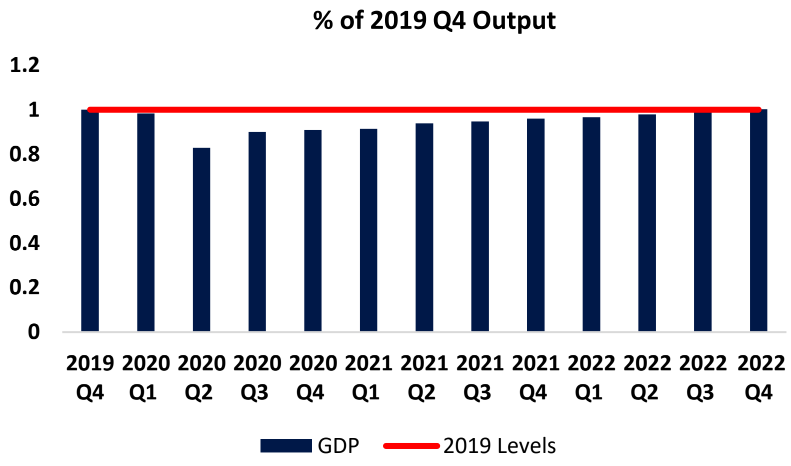
Finance and Insurance Value Add

The financial services sector was hard hit by the pandemic. The downturn in global and domestic asset prices led to a deterioration in the incumbent financial institutions' capital base through fair value losses as well as an increase in expected credit losses due to the quick deterioration in the macroeconomic environment. Since the nadir of the pandemic when GDP

Definitions:
Sell = REDUCE EXPOSURE iN YOUR PORTFOLiO TO ZERO
UNDERWEiGHT = REDUCE EXPOSURE iN YOUR PORTFOLiO TO LESS THAN 5% FOR THiS PARTiCULAR ASSET
MARKETWEiGHT/HOLD = EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLiO
OVERWEiGHT/BUY = EXPOSURE TO THiS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLiO

declined by approximately 15.6% during Q2 2020, the economy has made some amount of recovery, with the financial services industry following closely behind as seen in Figure 1.1.

Using Q4 2019 seasonally adjusted quarterly GDP as the last pandemic-free quarter, it is evident that the general economy is approximately back to pre-pandemic levels (off by approximately 0.1% which may not be statistically significant). Likewise, the financial sector based on economic output as represented by the Finance and Insurance sector in the national accounts is also close to/at pre-pandemic levels, being lower than the 2019 Q4 output by only 0.4%. While these are welcomed developments, there still exist possible headwinds for growth going forward. These include the lagged impact of higher rates generally in the economy and the tightened monetary stance which has the central bank angling for higher deposit rates and slower credit expansion which are both negatives for the growth and profitability of the finance sector.



Deposit Taking Institutions Profitability

Looking deeper at the financial industry specifically, several things become clear. Firstly, again using December of 2019 as the last pandemic-free quarter, the sector is not yet back to its pre-pandemic level of profitability. This is seen by the Return on Assets (ROA), which as of December 2022 stood at 1.90%. This compares to the pre-pandemic ROA of 3.00%. The decline in ROA for 2020, was due to the large downturn in asset prices due to the shutting down of the global economy due to the pandemic, while the subsequent recovery and accommodative monetary policy boosted non-trading income and aided the mild recovery in 2021. The global shift in monetary policy has however weighed on growth in 2022. The BOJ made its first hike effective in October 2021 and has since been hiking for the majority of 2022. The fed started its hiking cycle a bit later, on March 22, but has likewise been hiking for the majority of 2022. This shift has culminated in a decline in asset prices, particularly bond prices with the largest decline in JAMAN bond prices for example occurring in early 2022. This therefore negatively impacted bank profitability which also showed in DTI net profits which are down relative to 2021 and are also still below pre-pandemic levels.

Relevant Ratio (Total Financial System)	Dec-19	Dec-20	Dec-21	Dec-22
Loans (net of prov.): Total Assets	50.60%	49.55%	48.07%	51.00%
Prov. for Loan Losses: Total Loans (gross)	2.76%	3.34%	3.12%	3.11%
Return on Assets (for the Calendar Quarter)	3.00%	1.30%	2.30%	1.90%
Capital Adequacy Ratio [CAR]	14.51%	14.35%	14.15%	14.20%
NPLs (3 mths & over): Capital Base + Prov. for Loan Losses	9.41%	11.48%	12.27%	11.13%
Net Profit Billions (DTIs)	57.00	25.00	47.00	44.20
Source: Bank of Jamaica				

Asset Quality and Capitalization

Definitions:
Sell = REDUCE EXPOSURE iN YOUR PORTFOLiO TO ZERO
UNDERWEiGHT = REDUCE EXPOSURE iN YOUR PORTFOLiO TO LESS THAN 5% FOR THiS PARTiCULAR ASSET
MARKETWEiGHT/HOLD = EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLiO
OVERWEiGHT/BUY = EXPOSURE TO THiS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLiO

Likewise, asset quality while improved since the pandemic lows, is still not back above pre-pandemic levels. Notably, for DTIs the portion of NPL to the capital base + provisions for loan losses remains elevated at 11.13% while the overall NPL to total loans currently stands at 2.6%, higher than the pre-pandemic levels of 9.41% and 2.2% respectively. This has necessitated greater loan loss provisioning as evidenced by relatively elevated Provision for loan losses as a proportion of total gross loans. Note, the deterioration in asset quality was largely a result of the economic downturn caused by the pandemic which impacted the credit quality of borrowers (increased likelihood of default) given the deterioration in the macro-economic environment.

Despite not being back to pre-pandemic levels of profitability and asset quality, the industry nonetheless remains adequately capitalized. This is evidenced by the total industry Capital Adequacy ratio of 14.20% which while slightly below the pre-pandemic levels of 14.4% in December 2019 (or 14.7% in March 2019 for an even further look back period) the system remains within the BOJ regulated limits. In addition, the BOJ in their 2022 financial stability report noted that in their usual stress testing, DTIs remain relatively resilient in the face of interest rate shocks, while the securities dealers remain somewhat more vulnerable. These stress tests involved a 200-basis point increase in domestic yields and a 150 basis points increase in foreign yields and showed negligible impact on the combined DTI CAR ratio.

However, there are several signs of declining liquidity and increased liquidity risk, but the situation remains manageable. The liquidity coverage ratio for DTIs fell to 186.9% at the end of 2022, a large decline from 232.1% at the end of 2021. This liquidity ratio is defined as a ratio of high-quality liquid assets to expected fund cash outflows for 30 days (the time it is often thought to take for policymakers to intervene in the case of a crunch). The benchmark ratio is 100% and hence despite the reduction in the overall LCR ratio DTIs still have sufficient liquidity.

Sector Outlook

As mentioned prior, the industry is still below pre-pandemic levels of profitability as measured by net profits and return on assets. This is partly because of reduced non-interest income as asset markets are still being weighed down by the impact of both domestic and global monetary policy. The high levels of inflationary pressures that have facilitated higher domestic rates have however been declining in recent months which has facilitated a temporary pause in policy rate hikes by the BOJ. In addition, despite the profitability of the sector not fully rebounding, the economy is above pre-pandemic levels of output and is widely expected to avoid a recession in 2023 even as the global economy slows. For example, the IMF is projecting real GDP growth of 3% for Jamaica in the 2023 calendar year. These facts filter directly into our outlook for the finance industry.

Firstly, the Jamaican economy continuing its strong run and avoiding a major recession represents a net positive for the industry. This is facilitated through greater economic activity and by extension the prospect for increased fee income, a recovery in domestic asset prices, and a recovery in asset quality necessitating less expected credit losses. While the BOJ has also noted that they do not see a recessionary risk in the near term, we remain cautiously optimistic over the same horizon. This is due to the possible lagged impact of the current hiking cycle likely continuing to play out, coupled with the potential impact of slowing United States (US) growth on the domestic economy. For reference, the Fed in their March 2023 summary of economic projection is predicting US real GDP growth of 0.4% while noting that risks remain that may lead to lower growth. The negative impact of slower global growth if protracted and filtered into the domestic economy would likely be a negative for bank income through lower fees and commission income.

On the other hand, the declining pace of inflation, which has subsequently facilitated a pause in domestic rate hikes has its benefits for the industry. Being closer to the end of the hiking cycle is likely to bring greater stability to both domestic and global bond prices as international central banks such as the Federal Reserve are also thought to be getting closer to peak rates. This therefore will likely provide benefits in terms of trading gains as this would stem the downward drift in global bond prices which we have seen in 2022. To the extent that there are rate cuts (although we don't expect a commensurate sharp decline in interest rates to match the swift increase that we saw in this hiking cycle) this will also positively benefit trading gains as bond prices recover some of their 2022 losses. Hence, our base case outlook is for a slower pace of hikes and consequently, a relatively better market environment and trading performance this year relative to 2022 albeit not a quick return to the great bond pull market run seen leading up to 2019. This will non the less, therefore, translate to better trading income if our expectations come to pass.

In terms of net interest income, we note that higher rates have a varied impact across the industry. That is, it is more so dependent on the composition of assets and specific asset liability management pursued by the institution in question. That is, it is dependent on how quickly assets re-price relative to liabilities. One such showing of this dynamic is the fact that since the start of the year, longer-term loan rates for DTIs have declined marginally by 8 basis points to 11.34% while the weighted average deposit rate has increased by 55 basis points to 1.70% based on BOJ data. Likewise, the domestic interbank 30-day certificate of deposit rates have increased to a minimum of 8.80% at the end of December 2022, up from 3.75% in 2021. This, therefore, points to liabilities and shorter-term rates being priced quicker than longer-term rates. Given this context, we do not conclusively believe that higher rates are necessarily better for the sector as a whole and lower rates in the case of a shift to a more accommodative policy are likely to benefit the sector.

Sector Developments

Currently, the two (2) most pertinent developments in the sector are the implementation of IFRS (International Financial Reporting Standards) 17 and the implementation of Basel 3, which the regulators are tentatively about to implement. Basel III is a set of global regulatory standards developed by the Basel Committee on Banking Supervision, an international committee of banking supervisors, to strengthen the banking sector's resilience. The main objective of Basel III is to improve the quality and quantity of capital held by banks, increase the level of liquidity buffers, and introduce new measures to manage risks such as credit risk, market risk, and operational risk. Hence it is expected that the full implementation of Basel III might lead to higher capital requirements for some institutions in the industry. This is particularly true as the Basel III framework includes additional capital charges for credit risk, market risk, and operational risk, and as such riskier loans for example will require greater capital reserve requirements.

IFRS 17 is a global accounting standard that specifies how insurance contracts should be accounted for and reported in financial statements. This standard was developed to replace the existing IFRS4 standard, which contained too many inconsistencies in accounting practices among insurers. IFRS 17 applies to all insurance contracts, including reinsurance contracts, that an insurer issues and to all types of insurance entities, including mutual insurers and cooperative insurers. It is effective for annual periods beginning on or after January 1, 2023, with earlier adoption permitted. The expected impact is that there are going to be increased costs associated with adhering to the standard which includes staff training and updating systems to aid the transition. Notably, some companies have already incurred the costs of transitioning or have already started to incur such costs in preparation for the transition.

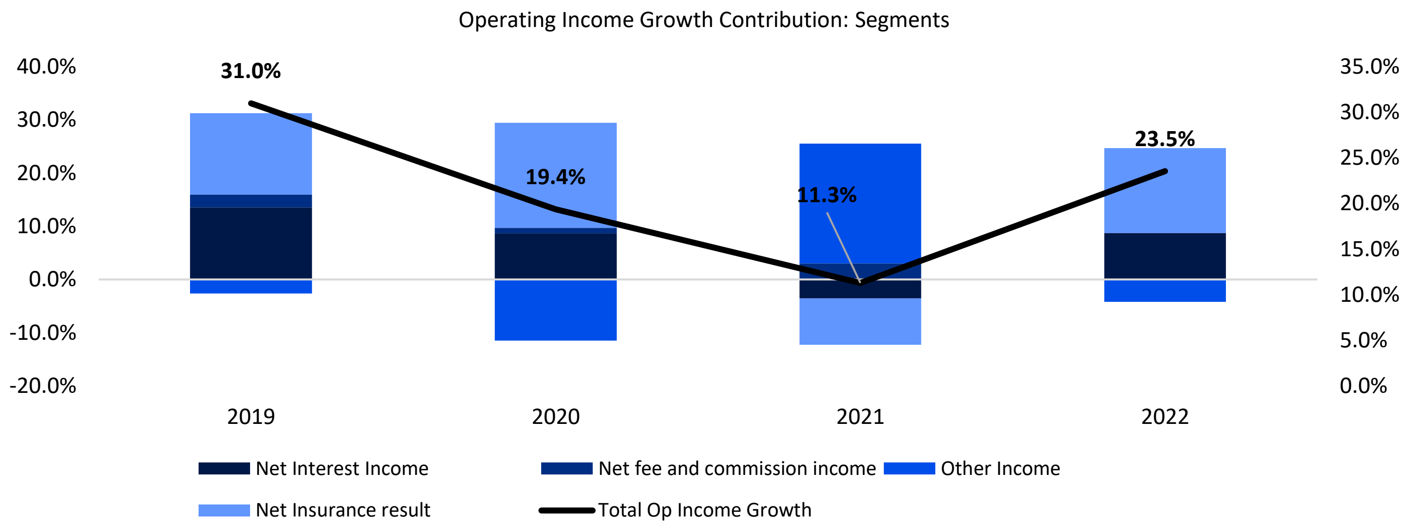
Historical Financial Performance

Income Statement Extract ('000)	FY2019	FY2020	FY2021	FY2022	TTM	6M 2022	6M 2023
Interest Income	65,068,228	74,421,878	74,574,816	84,923,549	92,363,450	44,512,909	51,952,810
Interest Expense	-20,473,144	-21,932,169	-25,947,849	-25,724,687	-31,162,223	-12,130,362	-17,567,898
Net Interest Income	44,595,084	52,489,709	48,626,967	59,198,862	61,201,227	32,382,547	34,384,912
Net Fee and Commission	19,179,833	21,369,407	22,488,994	26,132,751	26,918,059	12,954,368	13,739,676
Investments & Other Income	12,974,543	2,511,782	27,037,702	21,961,010	19,270,871	8,073,963	5,383,824
Net result from insurance activities	14,431,515	32,455,991	22,951,692	42,303,994	34,074,906	15,925,825	7,696,737
Operating Expense	-64,736,903	-81,565,804	-94,850,111	-104,460,096	-104,118,000	-51,730,355	-51,388,259
EBT	37,588,396	27,573,476	26,595,533	45,869,034	37,748,103	18,094,758	9,973,827
Net Profit to Shareholders	**29,869,398**	**19,090,378**	**14,226,671**	**27,318,907**	**21,111,624**	**10,434,524**	**4,227,241**

Financial Year 2022

Greater Operating Income Growth

As can be seen from the table above, the group generated an operating income of $149.6 billion, representing an increase of over 23.5% compared to 2021. The main contributing business line to the operating income growth in 2022 was the net insurance result which contributed 16.0% to growth followed by net interest income at 8.7% and then net fees and commission income of 3.0%. Lastly, the other income category, which includes foreign currency and investment gains, dividends income, provisions for loan losses, and other operating income contributed negatively to growth of -4.2%. Notably, over the period 2018-2022, the group has seen historically robust growth in income with a compounded annual growth rate of 21.1%. Since 2018, the largest driver of growth has typically been the insurance segment while the Net fee and commission line has been the most consistent positive contributor while the other income revenue line item has been the most volatile.

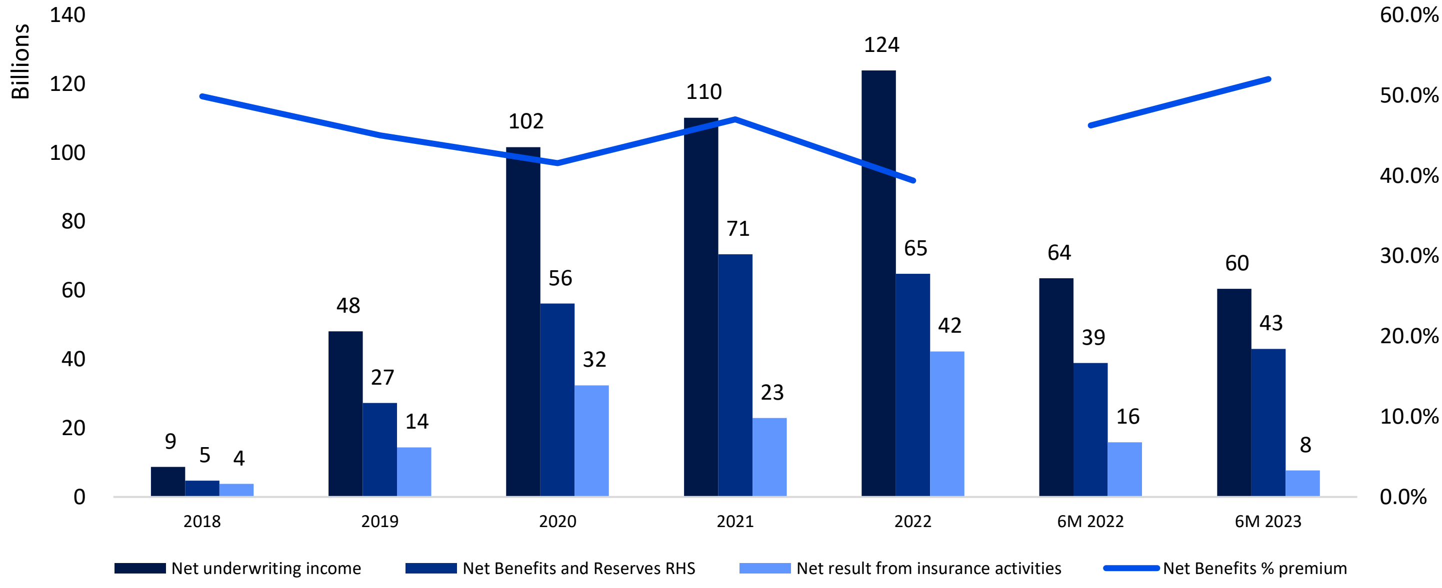


Disclaimer: The information contained in this Analysis is published for **general information purposes only.** Barita Investments Limited ("Barita") makes no representations or warranties of any kind, express or implied, about the completeness, accuracy, reliability, suitability, or completeness of the information presented. Further, prices of securities may fluctuate and statements as to historical performance or financial accretion are not intended to mean that future performance or future earnings for any period will necessarily match or exceed those of any prior period. Any reliance placed on this information is at your own risk and neither Barita and its affiliates nor their directors, representatives, employees and/or associated persons assume or accept any liability or responsibility whatsoever as regards any investment decision made by any person arising from this Analysis. There are risk factors associated with any prospective investment. Please consult your licensed investment advisor before making any investment decision.
Barita, its affiliates, directors, representatives, employees and/or associated persons may have or have had an interest or be interested in any investments or securities mentioned in this Analysis at any time and may make a purchase and/or sale or offer to make a purchase and/or sale or act as principal or agent of any such securities or other financial instruments from time to time.
This Analysis and the opinions therein are as at the date of this Analysis.

Definitions:
Sell = REDUCE EXPOSURE iN YOUR PORTFOLiO TO ZERO
UNDERWEiGHT = REDUCE EXPOSURE iN YOUR PORTFOLiO TO LESS THAN 5% FOR THiS PARTiCULAR ASSET
MARKETWEiGHT/HOLD = EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLiO
OVERWEiGHT/BUY = EXPOSURE TO THiS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLiO

Insurance is the main driver..but

The operating income from insurance increased by 84.3% to $42.3 billion in 2022 from $23.0 billion in 2021. The improved performance of this operating segment was due to increased gross premiums written coupled with lower levels of reinsurance, which led to higher net underwriting income. This higher net underwriting income in conjunction with substantial changes in actuarial reserves thus largely outweighed increased claims payouts. Gross premiums rose by approximately 9.8% for the year, while net premium income as a portion of gross premiums was 75.2% up from 73.5% in 2021, pointing to the insurance segment retaining greater risk. The driver in gross premium growth was improved performance from annuity, life, and health, and general insurance lines as the group noted a strong rebound in insurance product demand for the year. Hence, net underwriting income grew by 12.4% to $123.9 billion up from $110.2 billion in 2021.



Net benefits payouts however increased by over 47%. This increased payout was outweighed by the company recouping some of this through reinsurance, which covered some claims and substantial changes in actuarial reserves. Hence the 'Reinsurance on Policyholders' and Annuitants' Benefits and Reserves' line item which represents both the reinsurers' coverage of claims and actuarial reserves adjustments increased by over 625.6% to $48.7 billion from $6.7 billion. The net effect of this was the aforementioned 84.3% growth in net results from insurance activity. In addressing the actuarial change, it was noted that the movement in reserves was a result of capitalizing on investment opportunities that allowed for greater balancing of Assets & Liabilities, as well as prudent expense management which led to changes in expense assumptions.

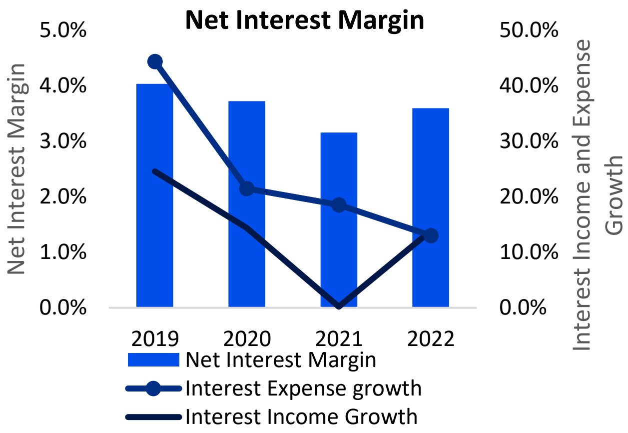
---Note- Actuarial reserves for life and annuity contracts which comprise most of Guardian Life's liabilities (NCB's largest insurance subsidiary), represents the estimation of the present value of future claims and expenses of their insurance contracts. Hence, assumptions that go into changes in this reserve include investment returns, discount and borrowing rates, mortality rates, and policy maintenance expenditures. ---

Net Interest Income: Reversal of Margin Contraction

Net interest income, which was the second largest contributor to growth for 2022, increased by 21.7% to $59.2 billion. This was facilitated by a 13.9% increase in interest income which outweighed a slight decline in interest expense (down 0.9% relative to 2021). Against this backdrop, the net interest margin came in at 3.6%, which represents a recovery from the

3.2% seen in 2021. The improvement in interest income was due to an increase in the group's loan book which facilitated an increase in interest income from loans of approximately 10.8% or $4.7 billion. The average interest rate on their loan and card portfolio decreased during the year, this increase was primarily because of the increased size of their loan portfolio (loans and advances increased by 11.0% or 57.5 billion to 581.0 billion as of September 2022). The other major driver was an over 20.7% or J$6.1 billion increase in interest income from investment securities.

interest expense on the other hand primarily reflected an over 72.1% or $1.8 billion decrease in interest expense associated with policyholders' benefits. This typically reflects the cost to fund policyholder payouts, particularly as benefit payout might not match asset maturities and hence borrowed funds might be utilized. Hence the lower interest on these payouts might be a reflection of higher investment returns and/or better asset-liability management, two things that management highlighted as improving for the year and hence also led to the aforementioned actuarial reserve releases.



Historically, net interest income has seen double-digit growth for all but one of the years between 2018-2022. That being 2021 when it contracted by 7.4%. The reduction in net interest income in 2021 was primarily due to stagnant growth in interest income of 0.21%, while interest expense increased by 18.31%. Management attributed the fall in interest income to a lower rate environment in 2021 and continued reprieve offered to their customers who were struggling with the pandemic, coupled with liabilities repricing higher, which together acted to compress the net interest margin.

Net Fee and Commission Income: Reliable growth

Fees and commission income grew by 16.2% in 2022 to $26.1 billion. This represents an acceleration from the growth rate of 5.2% in 2021. This growth in 2022 was driven by a rebound in business activity which has contributed to higher transaction values and volume. Notably, this represents 4 consecutive years of growth making it the most consistent revenue stream, albeit with a small contribution to overall operating revenue growth due to the relative size of this income line (an average contribution of 2.8% over 2019-2022). Nonetheless, net fees and commission income has enjoyed double-digit growth every year between 2019-2022 except in 2021 when growth was 5.2%. The performance of fees and commission income by the Group for 2021 had been attributed to the initial impact of the pandemic on consumer activity and volume in addition to the Group actively trying to incentivize the use of their online platform through the reduction of some user fees (this would therefore partly explain the slowdown in the growth of net fees and commission income compared to the 20.90% and 11.42% growth seen in 2020 and 2019 respectively). Also, recall that the initial addition of the increased stake in Guardian holding would have also bolstered the group's fee and commission income in the 2019 and 2020 financial years.

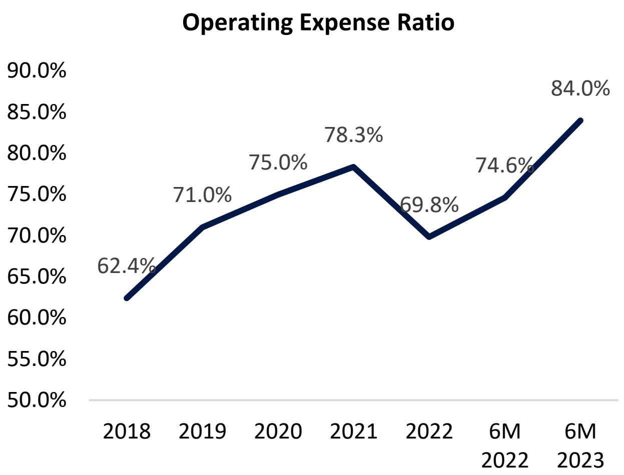
Other Income Remains Volatile

Other income, which includes loan provision, dividends income trading gains, and other operating income declined by 18.8% to 22.0 billion for 2022. Effectively, it was the only segment contributing negatively to growth. This decline mainly reflected an over $6.3 billion decrease in gains on foreign currency and investment activity. This comes as the financial markets were more challenging in 2022 relative to 2021. In 2022, this line item in other income was the sole contributor to the decline with the other segments improving slightly i.e a 6.3% increase in other operating income to $5.6 billion, a 7.9% increase in dividends income to $2.5 billion and a 19.5% decrease in provisions for loan losses from $3.4 billion to $2.7 billion. The increase in dividends income was primarily from the company's holding of equity securities and the reduction of loan loss provisions occurred as the macroeconomic environment improved over the reporting period reducing provisioning needs.

Historically, this revenue segment has been the most volatile revenue stream for NCB, which is expected since its performance is highly linked to the fortunes of the financial markets. That is, the sub-component most responsible for the volatility of this revenue stream has been the gains on foreign currency and investment activity components. While the outturn for 2022 was lower than 2021, it was better than the 2020 outturn of $2.5 billion which was heavily impacted by the large downturn in global financial markets due to the Covid-19 pandemic.

Operating Expenses: a Slowdown

Operating expenses grew by 10.1% to $104.5 billion in 2022. This is a noticeable slowdown from the 16.3% growth seen in 2021. The largest expense increase was the other expenses line item which grew by 13.3% or $5.2 billion. Going more in-depth, this reflected increased costs for property, vehicles, and ABM maintenance as well as utility costs. Secondly, technical, consultancy, and professional fees continued to grow as the group aims to position itself as a digital-first bank. This slowdown in the growth of operating expenses coupled with fast growth in operating income led to the Group's operating expense ratio declining to 69.8% for 2022, down from 78.3% in 2021.



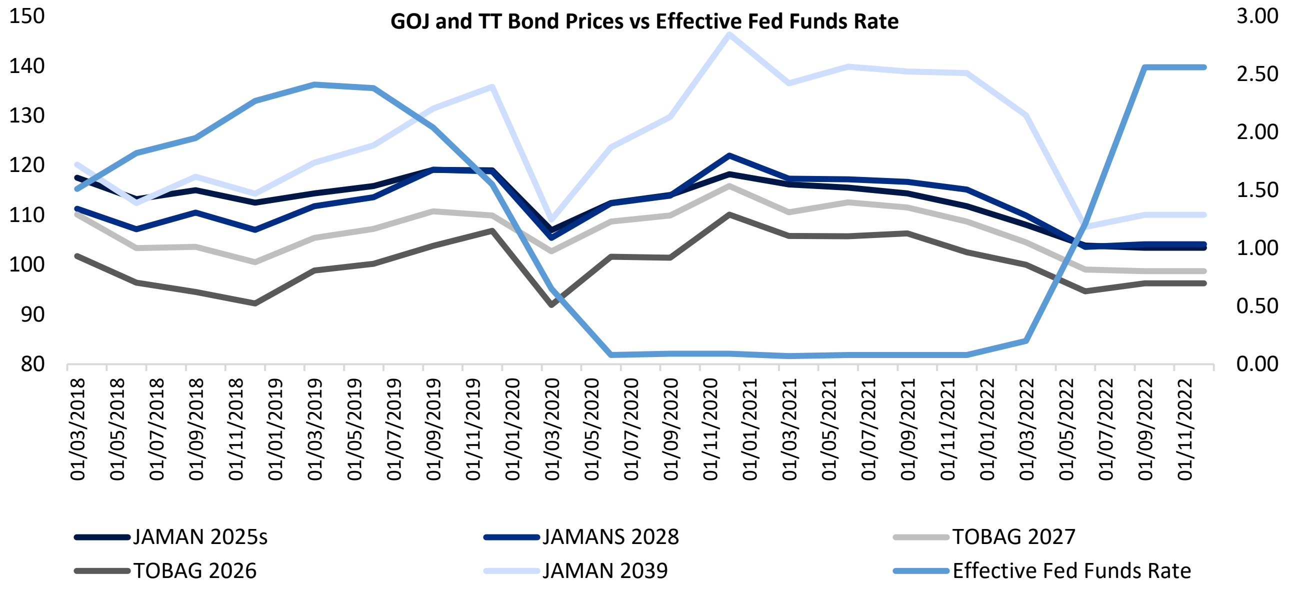
Looking back at the last five financial years 2018-2022, operating expenses have been on a notable uptrend, rising from J$43.43 billion to $$104.5 billion in 2022. This trend increase in operating expenses was a primary contributor to the climb in the company's cost-to-income ratio from 62.4% in 2019 to 78.3% in 2021. Over the period, the increase has primarily been attributed to higher staff spending as well as the Group's continued investment into its technological infrastructure, particularly as the company continues to push to be a leader in the domestic fintech and data space. This was exemplified in 2021 when the Group's spending on technical consultancies increased by 178% or $6.4 billion (from $3.58 billion in 2020 to J$9.94 billion in 2021) in support of ongoing strategic plans to become 'digital-first'.

Net Profit Recovery and Continued Other Comprehensive Loss

Share of profits from associates increased by 115.3% to $732.5 million in 2022, reflecting the combined earnings of associate companies RGM Limited, Royal Star Holdings, and other, more immaterial associates. In summary, the increased profits from associates, coupled with increased revenue growth and a slowdown in operating expense growth culminated in net profit after tax attributable to shareholders increasing 92.0% to $27.3 billion, compared to $14.2 billion in 2021. Noticeably, this is the Group's highest net profit in 3 years, with 2019 coming in at $29.9 billion, including one-off gains from the disposal of investments in associates.

Definitions:
Sell = REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO
UNDERWEIGHT = REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET
MARKETWEIGHT/HOLD = EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO
OVERWEIGHT/BUY = EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO

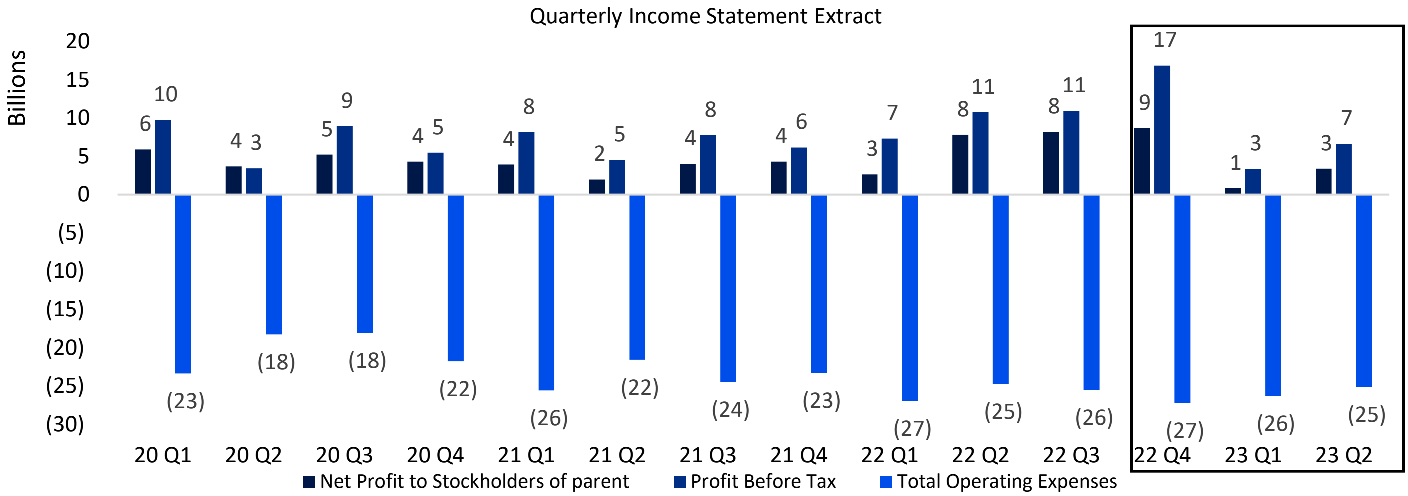
Despite this improvement in net profit, total comprehensive income attributable to shareholders for the period came in at a loss of $12.4 billion. This came as the group racked up large unrealized losses on securities carried at fair value through other comprehensive income to the tune of approximately $52.3 billion. This compares to fair value gains of $4.5 billion in 2021. Most of the instruments that the Group recognizes in FVOCI (Fair Value through Other Comprehensive Income) are Government debt securities (approximately 73.5% of FVOCI investment securities are government paper) and as the table below shows, both GOJ (Government of Jamaica) and TT (Trinidad and Tobago) government bonds saw steep price declines in the wake of the global shift to more restrictive monetary policy. This, therefore, drove the losses that NCBFG has seen in other comprehensive income.



First Half of FY 2023 and Outlook

For the first half of FY 2023 (6M 2023), NCBFG produced total income of $61.2 billion, compared to $69.3 billion for the same period last year representing a decline of approximately 11.7%. Looking at the group's operating segments, the banking and investment activities increased by 0.2%, while the insurance arm saw a fairly large decline producing net results of $7.7 billion, compared to $16.0 billion in the prior year, representing a decline of 51.7% and the driver of the overall decline in income for the quarter.

This weakened performance came on the back of a reduction in top-line premium revenue, while the company ceded more to reinsurers (73.2% retention ratio for the 6 months compared to 75.6% for the same period in 2021). This, therefore, culminated in net underwriting income declining by 4.8% to $60.5 billion. This top-line decline was coupled with higher net annuity benefits and reserves which amounted to $43.0 billion, compared to $38.9 billion in the similar quarter last year. The result was a 51.7% decline in net results from insurance activities generated in the period. Management attributed this decline in profitability to a one-off actuarial adjustment to the tune of $3.5 billion in the first quarter as well as higher health claim expenses due to the resumption of elective procedures postponed by the pandemic. On the other hand, the group had benefited from a large positive reserve movement in 2022, and hence the new actuarial movements based on these latest assumptions can be seen as a partial normalization. Digging even deeper into the subsegments, operating profit from insurance was split between general insurance and the life and health insurance sub-segment (primarily the group's subsidiary, Guardian Life). Typically, the life and health insurance segment has been the larger earner. This flip occurred primarily due to the actuarial reserve adjustments, which primarily impacted the life and health segment ($6.0 billion in operating profits for 2023 compared to $13.3 billion in 2022).



Lower trading Gains and higher credit provisioning create a drag on revenue

Other income in total declined by 33.3% for the 6M 2023 to $5.4 billion. This decline was due to a 41.7% increase in provisions for loan losses to $3.3 billion, combined with an $855.7 million or 15.8% decline in gains from foreign currency and investment activities. The increased provisioning relative to last year primarily reflects a normalization as last year included significant improvement via credit provision reversals due to the improving economic outlook. While more up-to-date information about the classification of securities holdings is not available it is noted that approximately 43.4% of the securities carried at fair value through profit and loss are quoted and unquoted equities based on the FY 2022 year-end breakout. Therefore, the reduction in trading occurred not only within the context of continued higher rates but also within the context of a more challenging equity market for the 6M March 2023 vs the comparable period last year.

Net Interest Income and Fee Income: Continued Growth

On the other hand, all other operating segments saw improved profitability. Specifically, the segment with the biggest improvement for the 6m 2023 was the net interest income which improved by 6.2% to $34.4 billion. This increase represented the net effect of a 16.7% increase in interest income and a larger 44.8% in interest expenses. Notwithstanding, the Group has seen a decrease in its interest margin. Hence, the improvement in the Group's net interest income was mainly a reflection of an increase in the group's stock of interest-earning assets, namely loans and investment securities, as opposed to margin improvements. This also points to the continued impact of the current rate environment which has seen the NIM continue to be below 2022 levels. Fees and commission income, which has always been a fairly consistent source of growth, continued its increase in the 6M 2023. This line item contributed $13.7 billion to total income for the 6M 2023 compared to $13.0 billion in 2022 a growth of 6.1%. This improvement was linked to the increased transaction volumes in the Group's payment services as the economic recovery continues.

Operating Expenses Cost containment continues

Total Operating Expenses YTD for the March quarter was $51.4 billion, compared to $51.7 billion for the comparable period last year, representing a 0.7% decline in operating expenses, which is notable given the group has in recent history been struggling with fast-growing operating expenses due to its digital transformation thrust as expressed earlier. Despite this, when compared to the decline in revenues (due to the insurance segment), the result is an increase in the operating expense ratio to 84.0%, compared to 74.6% for the comparable period in 2022. The decline in operating expenses YTD reflected lower professional and consultancy fees. Management noted that they expect to continue investing in digitalization but expect to see further improvement in operating efficiency going forward. However, the booking of lower professional and consultancy fees was an intentional initiative to cut operating expenses. **The above marginally lower operating cost did not outweigh the decline in revenues. Hence when further coupled with a higher tax expense for 2022 led to net profits attributable to shareholders decreasing by over 58.5% to $6.3 billion for 6M 2023 compared to $15.3 billion for 6M 2022.**

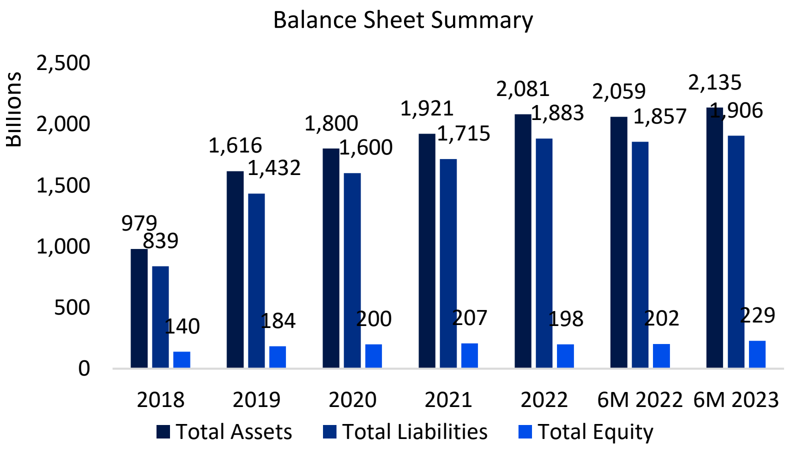
Partial Recovery in Other Comprehensive Income

While the profit outturn for the 6 months was less than stellar, there was some continued improvement in the capital base by way of positive comprehensive income. For the 6M 2023, the group generated other comprehensive income of $25.7 billion, compared to a loss of $19.8 billion last year. Also, this compares to the total other comprehensive loss of $52.2 billion for the entirety of the 2022 financial year. The recovery came on the back of the slight recovery in global bond prices in the last quarter of 2022. A part of the reason for this improvement was the Group opting to reclassify some of their investment security holdings to a "hold to collect" designation which means, based on accounting standards, they are allowed to now carry the assets at amortized cost as opposed to fair value through other comprehensive income, stemming the fair value losses, and hence a part of this recovery is likely due to this classification change. Nonetheless the impact of the above means that the total comprehensive income attributable to shareholders of the group for the period was $26.7 billion compared to a loss of $5.4 billion last year.

--We do not currently have the most recent classification of investment securities for the group, post-reclassification of some debt securities to Amortized costs. However, given their new classification, the Group is likely to further heighten their focus on liquidity given the holding to collect classification would discourage sale by requiring marking the entire portfolio to market--

Balance Sheet

Total Assets: As of March 2023, the group had **total assets** of $2.1 trillion. This represents an increase of approximately 3.7% relative to last year. The bulk of this growth was concentrated in an approximate $40.1 billion increase in loans and advances (or a 7.2% increase) and an over $36.0 billion increase in pledged assets, followed by a $33.0 billion increase in investment securities (or a 4.5% increase). The increase in investment assets came as the bank continued to increase the allocation of interest-bearing assets on its books which contributed to the increase in net interest income mentioned prior. Historically,



NCBFG's main assets have primarily been loans and advances as shown by its year-end 2018 balance sheet assets primarily consisting of 38% loans and advances. As of March 2023, the largest asset group was investment securities, which comprised 35.7% of total assets, up from 22% in FY 2018, while loans and advances declined to 27.9%. A part of the reason for the change in the composition of the company's balance sheet is a result of the diversification of the Group's business, primarily the expansion of the life insurance line (i.e., Guardian Life). However, year-over-year (YoY), there have not been any major changes in the composition of the Group's balance sheet.

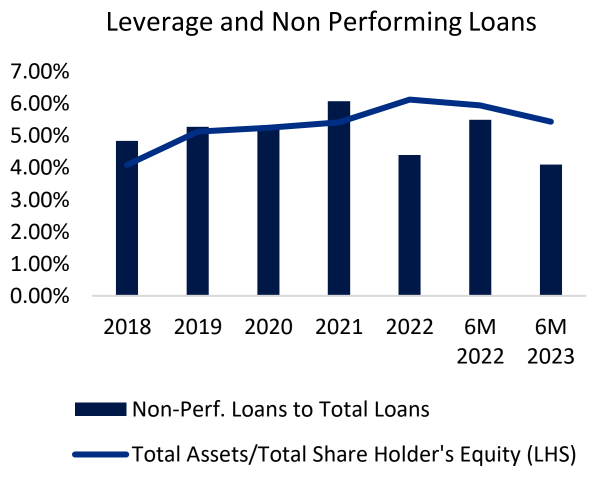
Total Liabilities: Most of the increase in total assets YoY was funded by an increase in liabilities, which rose by $49.0 billion to $1.9 trillion compared to an increase of $27.1 billion in the Group's equity balance. At a more granular level, the Group's asset base continues to be primarily supported by customer deposits, which totaled $714.5 billion on March 2023, compared to $706.6 million in 2022, representing growth of 1.1%. However, much of the increase in liabilities came from a $36.6 billion increase in obligations under securitization arrangements and a $17.2 billion increase in borrowed funds. These changes reflect the Group prioritizing raising liquidity through the debt market and securitizing assets. Given the growth in the significance of the Group's insurance segment, liabilities under annuity contracts represented 23.3% of total liabilities as of March 2023, compared to 4% for FY 2018. Invariably, the share of customer deposits in the funding base declined, moving from 50% in FY 2018 to 37.5% as of March 2023. The group's funding base remains low cost, particularly the banking division, which better positions them for the current high-rate environment relative to other financial institutions (particularly security dealers).

Total Equity: The group's equity balance increased over the last year by 13.4% to $229.0 billion. This increase has been attributed to higher retained earnings and retained earning reserves, which offset a $5.5 billion decline in fair value reserves caused by declining asset prices. Notably, the recovery of asset prices and the reclassification of some investment assets which facilitated recovery in fair value reserves mean that this account now stands at a negative $4.4 billion, a drastic improvement over the negative $26.9 billion seen at the end of September 2022. Likewise, total equity attributable to shareholders also improved over the 6 months to $176.3 billion or a 12.6% increase over the $156.5 billion in Q1 2022.

Capital

Based on the chart on the right, we can see that the Group's leverage (total assets to total equity) ratio has been increasing over the 2018-2021 period. This ratio moved from, 7.01x in 2018 to 9.30x in 2021. The increase in this ratio over the years was primarily due to the Group vastly increasing its liabilities as the Group has grown its deposit base as well as the expansion of the insurance line which has necessitated increased annuity and insurance contract liabilities. The ratio as of March 2023 stood at 9.3x, down from 10.5x at the end of FY 2022.

Also important is that the Group's equity base has also deteriorated due to the current macroeconomic environment which has led to a run down in asset prices and therefore a reduction in fair value reserves, which has weakened the capital position.



The Group suffered from some deterioration in asset quality as measured by the ratio of Non-Performing Loans to Total Loans. This ratio has trended upwards from 3.14% in 2016 to 6.08% in 2021. This upward movement has undoubtedly been impacted by the economic downturn caused by the pandemic. However, for the 6M 2023, this ratio fell to 4.1%, which is better than the FY 2022 ratio of 4.4%, and the 6M 2022 ratio of 5.5% and continues to be below pre-pandemic levels (NPL stood at 4.8% and 5.3% respectively in FYE 2018 and 2019).

Outlook

The current macroeconomic outlook is for continued domestic growth, above the historical long-run growth rate in the short to medium term. This is coupled with a quicker-than-expected fall in the rate of inflation back to the BOJ's target band of 4-6%. This has therefore made the current policy stance even more restrictive assuming a commensurate fall in inflation expectations and therefore means that a continued short-term pause and a medium-term cut (mid to late 2024) has become more likely. This owing to the expectation that inflation will return firmly to target (lower risk of upside spikes leading to a breach of the upper bound of the target range) by the end 2023 which means interest rate will likely go further into positive real rate territory (more restrictive) if the policy rate stance remains unchanged in 2024 despite a drop off in inflation. While it is possible that the BOJ may want to maintain positive real rates given the stronger-than-expected growth currently seen domestically, we non the less think the scope and possibility for a less restrictive policy will increase significantly in mid-2024. In the case of the global economy, while the projections are for slowing global growth in the short term this is also coupled with the expectations that global central banks are likely to pivot to more accommodative policy or at the least pause the pace of rate hikes.

The implication of the above is that fixed-income securities have become more attractive. This comes as the inflation pulse has weakened mildly with signs of further expected weakening which along with the expectation of slower growth has reduced the expectations of a much longer hiking cycle. This therefore bodes well for financial institutions such as NCB which derive a generous portion of their trading gains from investment in fixed-income securities. While the global outlook is for slowing growth, the apparent strength in the domestic economy also bodes well for the credit quality of the Group's loan book which reduces the probability of outsized impairment provisions such as the ones we saw at the start of the pandemic going forward. Further to this, we expect that going forward, the buoyancy seen in the Jamaican economy will continue in the short term and help to ensure economic activity remains robust enough to bolster fees and commission income.

Despite the positives outlined above a substantial portion of the Group's earnings is derived from their insurance business, which faces several tailwinds in the short to medium term. This is inclusive of a weakening in capacity for reinsurance globally which has led to greater reinsurance costs for both general and life insurers. This, therefore, is likely to lead to higher costs for consumers as these higher reinsurance costs are passed on, which may lead to weaker take-up of insurance products. There is also the possibility of continued normalization of actuarial reserve adjustments in later quarters, particularly if interest rates have indeed plateaued and begin to level off in the coming months. These risk factors only slightly offset the expected normalization of Covid-related life insurance claims going forward, which might mean continued improvement in this business segment as we have seen for the 6M 2023.

Valuation

Stock	NCBFG
Last Closing	J$67.95
52 Week High	J$105.00
52 Week Low	J$67.00
YTD Return	-14.98%
Trailing P/B	0.97X
Trailing P/E	7.54x
Forward P/E	6.99x
Target Price	J$84.33
Upside Potential	24.1%
Recommendation	**OVERWEIGHT**
Date	June 9, 2023

To value NCBFG we utilized two different valuation approaches. These include a comparables Price to Book Valuation and a residual income model. For the comparables approach, we forecasted a 1-year forward book value attributable to shareholders for the Group and compared it to the current P/B multiple of its peer group. We opted to use only other DTIs operating as fairly large financial conglomerates as comparisons and made minor adjustments to book values given the impact of the new IFRS 17 regulations. An average P/B ratio of 1.07x was observed from this peer group sample. Therefore, given our forecasted BVPS of $81.37, we arrived at a price target of $85.99. Note NCBFG currently trades at a P/B ratio of 0.99x, which is below the peer group average. As such, this forecast is contingent on an improvement in sentiment towards NCBFG, as well as a recovery in its profitability metrics, which might allow for the stock to trade closer to the peer group average.

In our second valuation approach, the residual income model, with adjustments to include comprehensive income in our return on equity calculations (hence utilizing total comprehensive income as opposed to just net income), we projected earnings for the next 5 years for the Group and subsequently subtracted an equity charge to the tune of 12.70%, our estimated cost of equity. Other key assumptions for this model were an average return on equity which falls to the cost of capital in the long run (no excess returns). Based on these assumptions, we arrived at a 1-year price target of $82.67. To arrive at our final estimate of fair value we used a simple weighted average of our two model outputs. The ultimate 1-year price target came in at $84.33, which represents an upside of approximately 24.1% compared to the closing price of $67.95 as of June 9, 2023. We, therefore, assigned an **OVERWEIGHT** rating to NCBFG as we believe the stock provides an opportunity for an attractive upside. **We however caution that downside risks continue to be embedded in the relative lack of positive sentiment around financial sector stocks which may impede the opportunity for price appreciation in the short term.**

Definitions:
Sell = REDUCE EXPOSURE iN YOUR PORTFOLiO TO ZERO
UNDERWEiGHT = REDUCE EXPOSURE iN YOUR PORTFOLiO TO LESS THAN 5% FOR THiS PARTiCULAR ASSET
MARKETWEiGHT/HOLD = EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLiO
OVERWEiGHT/BUY = EXPOSURE TO THiS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLiO