MAKING MONEY WORK FOR YOU.

LOCAL EQUITY REPORT

NCB FINANCIAL GROUP LIMITED

Barita Investments Limited
15 St. Lucia Way, Kingston
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Barita
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Company Overview

Stock	NCBFG
Last Closing	J$66.53
52 Week High	J$80.00
52 Week Low	J$55.00
YTD Return	0.53%
Trailing P/B	0.97x
Trailing P/E	20.31x
Forward P/E	6.99x
Target Price	J$79.24
Upside Potential	19.1%
Recommendation	OVERWEIGHT
Date	January 30, 2024

NCB Financial Group Limited (NCBFG) is a Jamaican-based holding company that controls the largest commercial bank in Jamaica by assets and profits, National Commercial Bank Jamaica. The primary business of the Group and its subsidiaries includes life & general insurance, commercial banking, 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, 52.68% of NCBFG is 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.

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 therefore 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. However, we do expect that the general operating 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 foresee that earnings growth will 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. As such, 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 $79.21.

Financial Performance

Income Statement Extract ('000)	FY2018	FY2019	FY2020	FY2021	FY2022	FY 2023
Interest Income	52,235,806	65,068,228	74,421,878	74,574,816	84,923,549	101,296,273
Interest Expense	-17,091,622	-20,473,144	-21,932,169	-25,947,849	-25,724,687	-38,495,233
Net Interest Income	35,144,184	44,595,084	52,489,709	48,626,967	59,198,862	62,801,040
Net Fee and Commission	15,863,974	19,179,833	21,369,407	22,488,994	26,132,751	28,077,569
Investments & Other Income	14,809,353	12,974,543	2,511,782	27,037,702	21,961,010	22,147,835
Net result from insurance activities	8,528,770	14,431,515	32,455,991	22,951,692	38,015,873	24,232,429
Operating Expense	-43,428,745	-64,736,903	-81,565,804	-94,850,111	-105,691,419	-117,673,606
EBT	33,988,918	37,588,396	27,573,476	26,595,533	40,349,590	19,961,884
Net Profit to Shareholders	**27,958,752**	**29,869,398**	**19,090,378**	**14,226,671**	**23,889,103**	**7,592,226**

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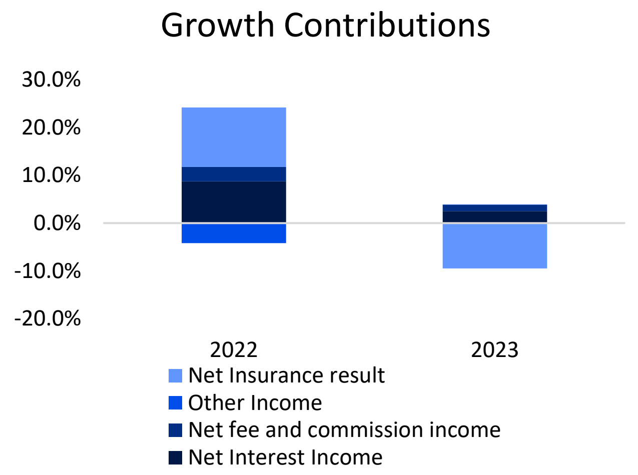
Financial Year 2023

Slowed Operating Income Growth

NCB generates income from 4 four major line items, which we categorize as net interest income, net fees and commission income, net insurance income, and other (which includes gains and losses on foreign currency and investments, loan loss provisions, dividends, and other operating income). Total income from all these sources for 2023 amounted to $137.3 billion which represented a decline of 5.5% relative to 2022. **When we decompose the growth contribution of each of the income streams the largest contributor to the negative outturn was the 9.5% contraction in net insurance services, which was only marginally offset by positive contributions of 2.5%, 1.3%, and 0.1% for net interest income, net fees and commission income and other income respectively.**

Net Interest Income: Historic Highs Continue

The Group generated net interest income of $62.8 billion, the highest outturn over the 2017-2023 period, representing growth of 6.1% relative to 2022. This can be further decomposed into growth in interest income of 19.3% to $101.30 billion, with interest expense growing at a much faster pace of 49.6% to $38.50 billion. As such, while the improvement in net interest income for 2023 was partly due to higher rates (particularly on investment securities), a major contributing factor is also likely due to the relatively subdued increase in interest income compared to interest expense (which increased as the rate on J$ deposit liabilities on the Group's balance sheet increased from an average of 0.08% in 2022 to 1.26% in 2023). For reference, the Group's investment securities increased by 16.0% for 2023, compared to a growth of only 4.1% last year.



Historically, net interest income has seen double-digit growth for all but one of the years between 2018-2022. That was in 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%. Therefore, while net interest income is currently at historic highs, the 2023 growth is still lower than historical norms, weighed down by the current monetary environment.

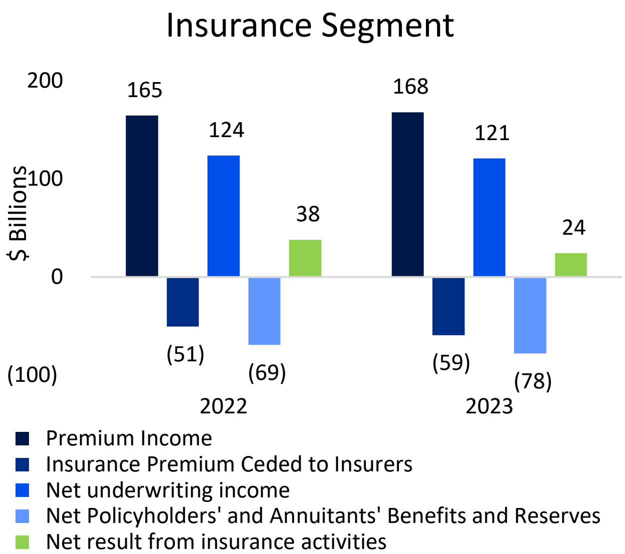
Fee and Commission Income: Stable reliable growth

The second largest positive contributor to net operating income growth was fees and commission income with a 1.3 percentage point overall contribution and growth of 7.4%, coming in at $28.1 billion. This has historically been the most consistent positive contributor to the Group's earnings. Management highlighted that the improvement was due to increased transaction volumes, particularly in the payment services segment, as well as credit card-related fees on new loans in the consumer SME Banking segment.

Net Insurance Results: Decreased Income, The Anchor for 2023

Despite the above-stated improvement in net interest income and fee income, the overall decline in total operating income was due to a 36.3% decline in net insurance results to $24.2 billion (negative contribution of 9.5%). In summary, this was due to a reduction in net underwriting income coupled with an increase in claims and benefits. This increase was linked to a general increase in claims and reserve movements during the year.

Looking at this further, premium income increased by 2.1% year-over-year. However, this was a noticeable slowdown in the pace of growth from recent years, with last year's premium growth, for example, being 9.8%. Additionally, in line with the global trend of higher reinsurance costs due to the tightening in global reinsurance capacity, the Group saw net reinsurance ceded (reinsurances net of commissions income) increase from $50.6 billion to $59.1 billion or 35.2% of premium income in 2023 compared to 30.7% in 2022. Essentially, this increased cost outweighed the slowing premium income growth and culminated in the decline in net underwriting income of approximately 2.4% to $121.0 billion.



Added to the above, the Group saw a fairly large increase in claims expenses and reserves movements. These items in total climbed to $78.0 billion compared to $69.2 billion in 2022. The increased claims expense as explained by management was primarily concentrated in their life segment, particularly health claims, with some additional general insurance claims. **These claims were likely because of the delaying of elective surgeries by policyholders during the COVID-19 pandemic, which continues to drive higher than normal health claims today. However, management noted that they expect this to normalize in the coming financial years.** Also, the positive actuarial reserve changes that reduced overall reserve and benefits charges in the 2022 financial year, were absent in 2023. Instead, the persistence of elevated rates harmed required actuarial reserves and led to higher charges, which further increased expenses. The outcome of these higher claims expenses and reserve charges, coupled with a 12.0% increase in commission and other selling expenses was the aforementioned 36.3% decline in Net insurance results.

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

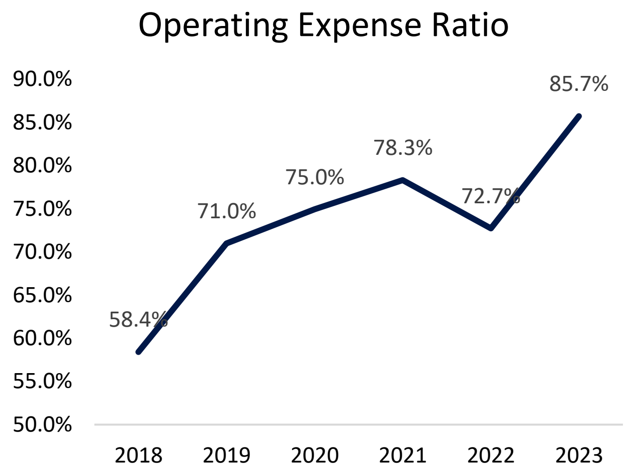
Other Income: Relatively Unchanged Year-Over-Year

The other income line item only grew by 0.9% for 2023 (a small growth contribution of 0.1 of a percentage point) to $22.1 billion, compared to $22.0 billion in 2022. The main contributor to the outturn was an improvement in foreign exchange and investment activities. Management attributed this improvement to the Group's holding of equity investments. In addition, the Government of Jamaica's debt securities, which account for a fairly large portion of the assets carried in profit and loss had a better price performance in 2023 compared to 2022. 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.

This improvement in fair value gains was complemented by marginal improvement in dividend income. However, these increases were outweighed by an increase in expected credit losses and general provisioning for loan losses, which grew by 96.3% to $5.3 billion, compared to $2.7 billion last year. However, this increased provisioning merely reflected a normalization, given that 2021 and 2020 had benefited from a reversal in expected credit losses arising from the economic recovery following the fallout from the pandemic, which reduced overall provisioning for both years relative to 2023. In addition to this, other operating income declined by 21.9% (this includes gains on disposal of assets etc.) to $4.4 billion. Against this backdrop, the impact of increased provisioning and ECL balanced the increase from foreign exchange and investment gains, which led to a fairly stable other income performance for 2023.

Operating Expenses: The Big Story.

Total operating expenses for the year came in at $117.7 billion, up 11.3% from $105.7 billion in 2022. Before 2023, operating expense growth for the Group was on a downward trajectory as they sought cost-cutting measures directly after the pandemic, for example, expenses grew 26.0% in 2020 before falling to a growth rate of 11.3% in 2023. Notably, there would have been even greater cost savings this year had it not been for the anticipated restructuring costs, inclusive of remuneration packages for the Group's outgoing top executives. In this vein, the major driver for the expense increase for 2023 was a $10.3 billion or a 20.4% increase in staff costs, to $60.6 billion. The only other noticeable increase was a 7.0% increase in other operating expenses. These increases were only marginally offset by a 16.9% decrease in depreciation and amortization expenses to $7.4 billion.



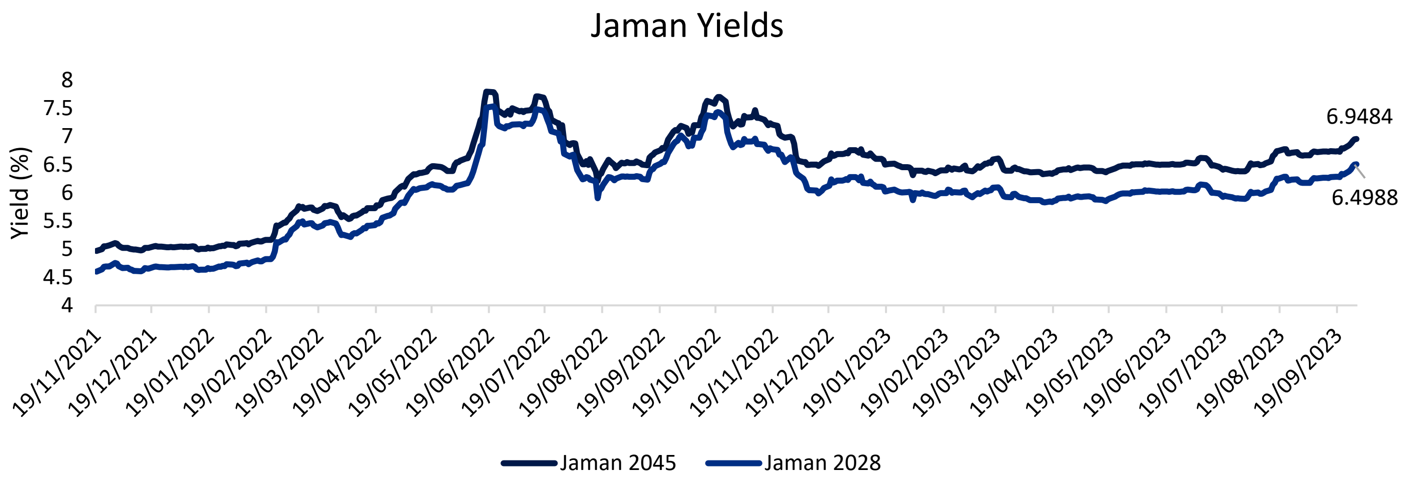
It was stated by management that the overall exercise resulted in total restructuring costs to the tune of $8.0 billion. It was also stated that it is expected that there will likely be an additional $8.0 billion going forward in cost savings that can be expected from changes made particularly in the last quarter of the 2023 financial year. Nonetheless, the increased restructuring cost meant that the Group's operating expense ratio increased significantly to 85.7%, relative to 72.7% in 2022 (Operating expenses as a portion of total operating income. Note that, management's cost to income ratio makes alterations by not including credit losses and was 82.6% in 2023 compared to 71.4%). Management, and particularly Mr Lee Chin has emphasized that a ratio above 70.0% was unacceptable and was a large part of his decision to take a more hands-on approach in the Group's operation. Management has also previously committed to getting this ratio closer to 50.0%.

Finally, Lower Profitability

The aforementioned decline in net revenue from all sources, precipitated by a decline in insurance income partly due to claims and actuarial reserve charges combined with higher operating costs necessitated by the restructuring exercise, resulted in operating profits declining by 50.6% to $19.6 billion, compared to $39.6 billion in 2022. Likewise, earnings before taxes declined by 50.5% to $40.3 billion, or a decline of $20.4 billion. However, after netting out the effect of taxes and minority interest, Net profit attributable to shareholders amounted to $7.6 billion, representing a decline of 68.2% relative to 2022.

Other Comprehensive Income: Continued Rebound.

The Group saw other comprehensive income recover from a loss of $47.6 billion in 2022 to a profit of $15.7 billion in 2023. Last year was a particularly challenging market, particularly in the case of GOJ securities. The relatively steep decline in JAMAN prices seen throughout 2021 and 2022, eased in 2023 (as shown by the increasing yields in the chart below, Yields and prices move inversely). This facilitated improved comprehensive income as the fair value losses on securities carried at fair value through other comprehensive income also eased. In addition to this, the reclassification of some investment securities further cauterized some of these losses. Overall, unrealized fair value gains in OCI amounted to $16.8 billion compared to $52.3 billion in losses in 2022 and therefore drove the majority of the recovery in other comprehensive income.



Balance Sheet

The Group's total assets increased by $144.6 billion year-over-year as of September 2023 to $2.2 trillion. This change in the asset base was funded by a $114.4 billion increase in total liabilities and a $30.2 billion increase in total equity.

The change in total assets over the year reflected growth of 7.0%, the majority of which was concentrated in the Group's holding of interest-earning assets. In particular, investment securities increased by $115.4 billion or 16.2% to $827.1 billion, loans and advances increased by $32.8 billion or 5.7% to $613.8 billion and pledged assets increased by $27.8 billion or 10.8% to $284.4 billion. These assets accounted for the bulk of the increases in total assets and were partially offset by a decrease in the amounts due from other banks to the tune of $46.3 billion or 24.9% to $139.5 billion. In terms of noticeable changes in the general asset composition of the Group, investment securities now represent 37.2% of total assets, compared to 34.2% last year. Management attributed this to the recovery in asset prices as well as additions of new investment securities, coupled with the change in the business model at NCBJ, (to hold to collect) which led to investment securities being carried at a higher fair value on the balance sheet. In addition to this, the growing importance of investments coincided with fairly slow loan growth (expected given the current monetary policy regime). Notably, investment securities comprised only 22.0% of total assets in FY 2018. 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).

Total Liabilities: increased by $114.4 billion or 6.1% to $2.0 trillion. This was facilitated by the usual culprits, consumer deposit growth of 4.6% or $32.6 billion to $747.9 billion, growth in the Group's repurchase agreements of 13.0% to $279.8 billion, and an increase in other borrowed funds to the tune of $26.4 billion or 17.2% to $179.7 billion and lastly an increase in annuity and insurance contract liabilities of $18.1 billion or 4.1%. Management highlighted that the deposit base increase was facilitated by the continued trust that the populace has in the institution. However, we note that this growth has slowed over the past year, partly as a result of monetary policy. For example, deposit growth averaged 14.1% over the 2019-2022 period (albeit the acquisition of Clarien Bank aided this growth in the past). Regarding the composition of the Group's liabilities, year over year there have been no significant changes, with consumer deposits, insurance contract liabilities, and repurchase agreement liabilities comprising 37.4%, 23.0%, and 14.0% of total liabilities respectively. Given the growth in the significance of the Group's insurance segment, liabilities under annuity and insurance contracts now feature more prominently in the balance sheet. Invariably, the share of customer deposits in the funding base declined, moving from 50% in FY 2018 to 37.5%.

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Total Equity: The over $30.5 billion improvement in total equity year over year was mainly attributed to a $17.5 billion improvement in fair value and capital reserves. This was owing to the strong improvement in other comprehensive income seen for the 2023 financial year. As stated previously, this was due to improving asset prices coupled with the reclassification of security holdings, which bolstered unrealized gains on securities classified at fair value through other comprehensive income. This therefore means that the hole created from the decline in asset prices in 2021/2022, which led to fair value and capital reserves declining to -$26.9 billion has shrunk to -$9.4 billion. In addition to this, the continued profitability of the Group led to increased retained earnings of $8.1 billion, which further aided the increase in equity over the year.

Capital

Management noted that the Group is currently meeting all of its regulatory capital requirements. We do note however, that a crude measure of total equity to total assets has improved from 9.3% to 10.1% in 2023, which as already evidenced by the improving equity balance has shown that the Group's capital position has improved. Regarding asset quality, the ratio of non-performing loans improved to 4.1% for 2023, compared to 4.4% in 2022 and remains firmly below pre-pandemic levels (NPL stood at 4.8% and 5.3% respectively in FYE 2018 and 2019).

Outlook and considerations

General Environment

As it relates to the general macro and policy framework, while we don't anticipate a swift decline in policy rates as quickly as they were increased in 2022, we do believe we are at the peak monetary policy cycle. In this regard, we believe this will bode well for the Group's equity balance, primarily based on their exposure to domestic and global debt instruments (stemming fair value losses in both profit and loss and other comprehensive income). This in line with the continued expected growth of the economy in the short and medium term will positively impact key operating segments.

IRFS 17 and BASEL 3

While insurance income slowed during the year, apart from the weak insurance performance, the general volatility that we have seen in this segment over the last 2 years has been due to the IFRS 4 treatment of actuarial reserve charges particularly as assumptions have been rapidly changing given the macroeconomic environment. This has caused excessive swings in earnings that have affected the insurance segment (positively in 2022, negatively in 2023). However, management has noted that IFRS17 will allow for greater smoothing of these effects and might allow for reduced swings in earnings due to reserve releases. Therefore, the large negative impact of the charges seen in 2023 might become less extensive with the adoption of the new standard. Secondly, the Group has noted that the implementation of Basel 3 will likely lead to greater provisioning needs. It is typically seen that the impact on adoption is for lower profitability in the short term before a normalization going forward. As such, the lower variability in insurance along with a stable macroeconomic environment will be counterbalanced by possible IFRS implementation costs and costs associated with BASEL 3 implementation.

Restructuring Cost and Profit Guidance

A theme from the Group's latest quarterly briefing was that the majority of the restructuring costs are now likely done. In addition to this, it was stated that there were additional cost savings done in the quarter and over the last year that were masked by one-off restructuring costs. **In that regard, management places a figure of approximately $8.0 billion due to restructuring costs as well as the cost savings going forward also being to the tune of $8.0 billion. As such, in addition to the $7.1 billion in net profit attributable to shareholders, management effectively gave guidance on the possible runway profit for 2024 of approximately $19.5 billion (using a 25% effective tax rate). In addition to this guidance was given for a return on equity of mid to high teens. Using 15% places this at around $25.5 billion, ultimately putting the implied 2024 net profit guidance in the range of between $19.5-$25.5 billion.**

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Potential Additional Public Offering

It is widely expected that the Group will return to market with an additional public offering of ordinary shares potentially in 2024. In this vein, the Group has announced its intention to issue up to 300 million in new shares. However, there remains little concrete information about the specifics of the raise. However, we are of the view that it is important to consider the possible impact of the raise on the Group's financial position. Firstly, it is expected that a portion of the raise will be used to pay down debt, which will have the impact of reducing the Group's current interest cost. While this has an immediate positive impact on the group's bottom line, this will to an extent, (how great, we cannot yet ascertain) however be counterbalanced by equity dilution, which all else being equal will have an uncertain impact on earnings per share.

The second reason for the capital raise, however, is to bolster the Group's capital position. We note that the recent downturn in debt markets has eroded the Group's capital base, which is further complicated by the expectation of BASEL 3 being implemented, which will further increase capital requirements. Therefore, if successful, a potential raise will increase the Group's capital cushion at a crucial juncture in time and help to further strengthen the financial stability of the Group for further long-term growth, even if it comes at the expense of short-term dilution.

Valuation

To value NCB we opted to use a residual income model and a historical Price to Book approach. The latter was utilized to incorporate into our analysis the possible scenario of sentiment, which has been fairly negative for the stock for the majority of the last two (2) years, failing to improve, resulting in the current trading multiple remaining over the next year.

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Trailing P/E	20.31x
Forward P/E	6.99x
Target Price	J$79.24
Upside Potential	19.1%
Recommendation	OVERWEIGHT
Date	January 30, 2024

We utilized several assumptions for the residual income model, in arriving at our projections of total comprehensive income for the financial year 2024. The first of which is positive but slowed economic growth, which impacts business lines such as commissions and fee income, as well as insurance premium growth. We also assumed that the financial markets, particularly the debt markets, notably the market for Jamaica Government securities, will see a better price performance in 2024 relative to 2023 as we expect that by mid to late 2024, there will be a concerted global push towards less restrictive monetary policy. **Given these assumptions, along with a cost of equity of 11.7%, we arrive at a multi-stage residual income model valuation for NCB of $83.91.**

To supplement this valuation, we utilized the prior mentioned historical P/B for NCB along with our forecast of the book value for the end of the 2024 financial year. Given our macroeconomic and capital market assumptions that fed into the total comprehensive income forecast for NCB as well as an expectation of a normalization of dividends, we arrive at a forecasted book value per share of $76.83 at the end of the 2024 financial year. Currently, the stock trades at a multiple of roughly 0.97x book value, hence in the scenario that sentiment does not improve, and the stock continues to trade at a similar multiple, this would give us a fair value target of $74.56, which effectively acts as the lower bound of our price target. **As such, our current fair value target price range is $74.56-$83.91, with a final target arrived at by taking the simple average of $79.24.**

Based on the closing price as of January 5, 2024, of $67.02, we estimate a one-year total potential upside of 19.1%. As such, we recommend that investors overweight NCBFG. There however remain caveats that include the continued depressed sentiment in financial sector stock, which may or may not improve or even

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worsen. In addition to this, the finer details on the pending APO have not yet been fully disseminated and its potential impact on per-share profitability (given dilution) and sentiment cannot yet be fully assessed.

Financial Statement Summary

J$'000	2023	2022	2021	2020	2019
Net Operating Income	137,258,873	149,596,617	121,105,355	108,826,889	91,180,975
Net Interest Income	62,801,040	59,198,862	48,626,967	52,489,709	44,595,084
Non-Interest Income	74,457,833	93,121,310	75,863,514	66,622,174	51,410,625
Operating Expenses	117,673,606	104,460,096	94,850,111	81,565,804	64,736,903
Net Income	15,335,927	39,922,845	20,075,606	26,883,412	31,164,938
Total Assets	2,222,801,512	2,078,688,601	1,917,127,972	1,800,260,275	1,616,299,602
Loans and Advances	613,788,134	580,987,814	523,488,890	452,954,936	423,102,600
Investment Securities	827,118,517	959,486,735	900,512,195	853,085,972	759,496,006
Customer Deposits	747,872,120	715,276,682	647,085,400	573,968,886	504,678,536
Liabilities Under Annuity and Insurance Contracts	459,549,252	437,175,410	433,056,798	405,014,541	394,615,307
Equity Attributable to Shareholders of The Parent	170,022,090	149,527,995	161,456,191	156,114,678	147,590,179
Return on Average Equity	7.36%	17.57%	8.96%	12.57%	21.52%
% Income From Banking Activities	82.35%	71.72%	81.05%	70.18%	84.17%
% Income From Insurance Activities	17.65%	28.28%	18.95%	29.82%	15.83%
Cost to Income Ratio	85.75%	68.58%	76.19%	68.48%	67.43%

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