The Analyst™ Note.

FCMB Capital Raise: Making Equity Choices to be National or International.

Issue Date:
Wednesday, August 07, 2024

A Market Intelligence and Strategic Advisory Group Report

Production:
Proshare Graphics.

As one of Nigeria's older Tier 2 banks listed on the NGX, FCMB (seeking to raise ₦150 billion via a public offering through 15,197,289,219 ordinary shares of ₦0.50K each at N7.30k/share, an offer currently in the market), faces a critical decision regarding the adoption of either a national or international license, considering the current recapitalisation requirements. Proshare analysts highlight the issues that should interest shareholders and other stakeholders.

Outline.

- Introduction.
- The Cost and Benefits of Growing Bigger.
- Tweaking the Cost-to-Equity Balance.
- Leaning into New Realities.
- Closing Thoughts.

Introduction.

Mid-sized banks can be grand or grounded depending on their governance, capital, and personnel approaches. FCMB started as a capital market specialist financier from its early days as a stockbroking operation, but over a few decades, it has turned into a financial lender still moored to its investment banking beginnings despite its commercial banking license.

In a recapitalisation era, where Nigerian banks must have core Tier 1 capital of N200bn for a national license and N500bn for an international license, the bank's shareholders have asked: What should we do? The answer is not easy (*see table 1*).

Table 1:

NIGERIAN BANKS REVISED MINIMUM CAPITAL REQUIREMENT.

Type of Bank	Authorisation	Minimum Capital (N'bn)
Commercial	International	500
	National	200
	Regional	50
Merchant	National	50
Non-interest	National	20
	Regional	10

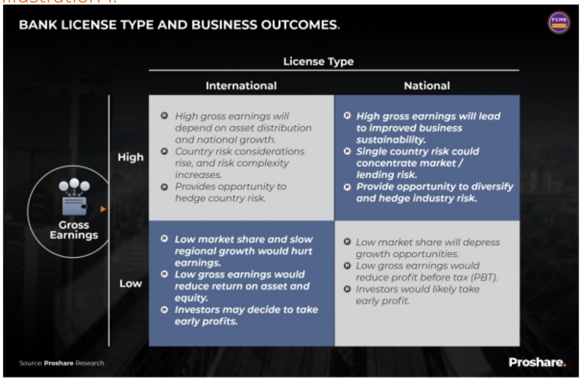
Source: CBN, Proshare Research

FCMB has been a resilient mid-sized bank with mid-sized banking opportunities and considerations. With the Central Bank of Nigeria (CBN) order for banks to raise their Tier 1 capital (excluding retained earnings), mid-sized banks will have a few hills and hillocks to cross; of particular importance is whether they should aspire to raise equity to N200bn on a national license or go for the economies of size on a N500bn international banking license. Proshare analysts argue that FCMB needs to evaluate its international license's incremental cost and benefit and act to accelerate the increase in shareholder value (the bank has a free equity float of 65.69% as of the year ended December 31, 2023). Analysts maintain that if it opts to maintain the present international bank status, it must be deliberate in its international operations and market strategy to justify the additional N300bn in equity capital needed to retain the license and status.

FCMB holds an international banking license, which requires a minimum capital adequacy ratio (CAR) of 15%. If the bank revised its license to a national license, it would need a minimum CAR of 10%. A further consideration is that the bank has held an additional 5% capital against risk-weighted assets for decades because of a single offshore United Kingdom (UK) subsidiary.

This would ordinarily not be an issue if the subsidiary were a key driver of the group's performance in FY 2022 and FY 2023; indeed, as of FY 2022, the UK subsidiary contributed 3.4% to pre-tax profit. Besides, 88% of the UK deposits were from deposit aggregators, the Central Bank, and the parent company, while 57% of the total loan exposure was to Nigerian customers. This was roughly double the combined 30% exposure of the remaining sixteen (16) countries outside the UK. While international exposure is helpful to the growth aspirations of lenders, it comes with challenges that require clever navigation (*see illustration 1*).

Illustration 1:

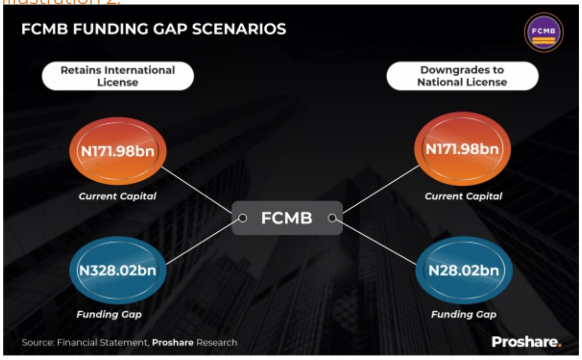


The Cost and Benefits of **Growing Bigger.**

From a cost-benefit analysis perspective, the bank is paying more in shareholder capital to maintain the license for international operations than benefitting from it. By implication, because of the 'prestige' associated with international operations, FCMB is sacrificing the opportunity to expand its earning assets by five to seven times the incremental capital it holds over a 10% capital adequacy ratio (CAR) level without raising additional capital.

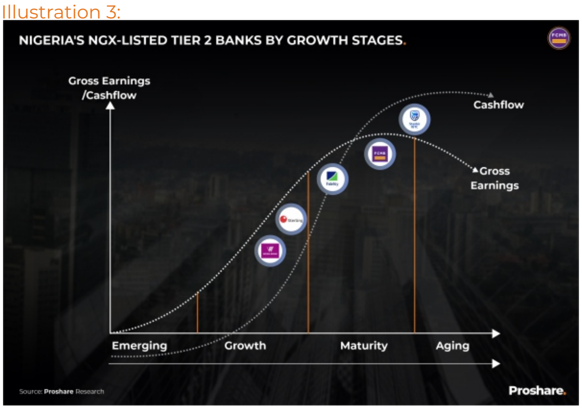
This becomes of more important concern considering the capital constraints it faces. The bank operated a 16% CAR in 2022 but slipped to 15% in H1 2023, despite raising additional Tier 1 (AT1) capital and benefitting from foreign exchange (FX) recapitalisation gains in Q2 2023 while generating gross earnings of 84% of FY2022 levels. Market observers believe that the more the bank pursues deposits to create further risk assets or loans and advances, the more capital it needs to raise to support balance sheet growth. The loan-to-deposit ratio (LDR) of the bank (as distinct from the group) was 59.73% in H1 2023, which was higher than the revised statutory ratio of 50% (down from the previous 65% under the immediate past CBN Governor, Godwin Emefiele). In H1 2024, the ratio scaled up again to 62.72%. Against the background of the recent recapitalisation template of the CBN, FCMB would be comfortable sustaining a strong CAR by raising additional equity of N28,02bn if it opted for a national license and N328.02bn if it chooses to retain an international license

Illustration 2:



Still, within what analysts consider to be a matured growth phase with headroom for increased market share and stronger operating cash flows, FCMB will need to devise a growth plan that nudges the bank along a transitional curve that strengthens gross earnings, business diversity, and technology adoption and adaptation. The growth stages of the listed tier 2 banks were gleaned from analysis of their respective operating and free cash flows and gross earnings (*see illustration 3*).

Illustration 3:



Tweaking the **Debt-to-Equity Balance.**

FCMB's ability to maintain deposit growth without further adverse consequences on its loan-to-funding guideline and the use of the N300bn Debt Issuance Programme is strongly linked to the adequacy of its capital base. Therefore, the size of FCMB's equity capital raise programme would be significant in managing the outcomes of its debt issuance and leverage. Analysts have noted that there is a limit to the extent of debt leverage it can accumulate by way of AT1 capital. Also, the cost of funds on the Additional Tier 1 capital with the average yield on earning assets shows the potential dampening effect on the bank's net interest margin. This could imply a sub-optimal strategy for capital management compared to increasing its core Tier 1 capital. In this context, its capital raise programme supports its fiscal stability.

The alternatives to managing its balance sheet without raising core equity capital would have been unsustainable and expensive. Therefore, the current recapitalisation effort is a timely corporate and regulatory intervention. However, analysts believe that the bank may have escaped the trap of the need to moderate deposit growth to improve business outcomes, which would hurt its market competitiveness. A successful capital raise would enable the bank to increase loans and advances without worrying about the necessary deposit base to support the growth, at least in the short run.

Leaning into **New Realities.**

FCMB's share price movements in the last year have symbolised investors' cautiousness and recent relief. In Q1 2023, investors were apprehensive of the bank's growth, and its share price movement was mainly bearish. By Q2 2023, investors were more positive with the bank's investors trading along what technical traders call a mild bullish flag or a slight but sustained upward glide in its share price.

With consideration of a rise in the bank's equity based on the Central Bank of Nigeria (CBN) recapitalisation announcement in Q1 2024, the bank saw a spike in its share price before a cooling-off sentiment took over by the end of the first quarter. From the second quarter (Q2 2024), the banking group's share price has seen strong variability along a bearish channel as investors soak in the consequence of a larger number of outstanding shares and a likely fall in earnings per share (eps) after the new equity issue (*see chart 1*).

Chart 1:

That said, most brokerage firms remain optimistic about banking sector stocks despite major global equity market selloffs, mainly driven by expectations of U.S. federal rate cuts and the aftermath of the windfall tax announcement. *They recommend taking a "Buy/Hold/Accumulate" position for banking stocks* while being more cautious about other sectors, where they suggest a "Hold/Sell" approach (*see table 2*).

Table 2:

A COMPENDIUM OF BROKER'S STOCK RECOMMENDATION
FROM AUGUST 6-9, 2024

FCMB

SECTORS	BANCORP SECURITIES	UNITED CAPITAL	MERISTEM	AFRINVEST
Banking Index				
ACCESSCORP	BUY	BUY	BUY	BUY
FBNH	BUY	BUY	BUY	BUY
FCMB	BUY	BUY	BUY	BUY
FIDELITYBK	HOLD	BUY	BUY	ACCUMULATE
GTCO	HOLD	HOLD	BUY	HOLD
STANBIC	HOLD	-	BUY	ACCUMULATE
UBA	BUY	BUY	BUY	BUY
ZENITHBANK	BUY	BUY	BUY	ACCUMULATE
ETI	-	-	HOLD	HOLD
WEMA	-	-	BUY	BUY
Consumer Goods				
BUAFOODS	SELL	-	HOLD	-
DANGSUGAR	HOLD	BUY	HOLD	HOLD
FLOURMILL	HOLD	HOLD	BUY	UR
NB	HOLD	BUY	BUY	BUY
NESTLE	HOLD	BUY	BUY	BUY
GUINNESS	-	BUY	BUY	REDUCE
INTBREW	HOLD	-	-	REDUCE
NASCON	SELL	-	HOLD	SELL
UNILEVER	HOLD	BUY	HOLD	REDUCE

SECTORS	BANCORP SECURITIES	UNITED CAPITAL	MERISTEM	AFRINVEST
Insurance				
AIICO	BUY	-	BUY	BUY
INTENEGINS	HOLD	-	-	-
Conglomerates				
TRANSCORP	HOLD	-	BUY	–
Industrial Goods				
WAPCO	BUY	BUY	BUY	BUY
BUACEMENT	SELL	-	BUY	SELL
DANGCEM	HOLD	-	HOLD	UR
Oil & Gas				
OANDO	HOLD	-	-	-
SEPLAT	HOLD	HOLD	HOLD	HOLD
OKOMUOIL	-	HOLD	-	SELL
TOTAL	-	SELL	HOLD	SELL
JAPAULGOLD	HOLD	-	-	-
ICT				
MTNN	HOLD	--	BUY	BUY
AIRTELAFRI	HOLD	--	HOLD	REDUCE
CHAMS	HOLD	--	-	-

Source: Bancorp Securities, United Capital, Meristem, Afrinvest, **Proshare** Research

Proshare.

Closing **Thoughts.**

FCMB's board and shareholders must decide whether big is beautiful or if playing the mid-size game is just where they want to be. After all, being a whale in shallow waters is just as dangerous as being a mackerel in a shark-infested river. The equity stakeholders in the FCMB Group must decide whether to take on an international or national banking license; their choice will have consequences for the financial lender's long-term corporate sustainability. The word 'Glocal' (thinking global and acting local) used to be an interesting catchword, but now it comes with a price tag.

Related Items.

1. FCMB Group Plc Public Offering Offer for Subscription of 15,197,289,219 Ordinary Shares of ₦0.50K Each.
2. FCMB Group Plc Commences Offer for Subscription at N7.30k Per Share.
3. CBN Approves Financial Accommodation for Unity Bank and Providus Bank Merger.
4. Stock Recommendation for the Week of August 06, 2024.
5. Banks Recapitalization Watch for the week ended August 02, 2024.
6. Zenith Bank Set to Raise N290bn Capital Through Rights Issue and Public Offer.
7. The Pains of A Windfall Tax: Appraising the NASS's Financial Act Amendment.
8. FCMB Group Plc Declares N59.48bn PAT in H1 2024 Unaudited Results, (SP: N8.00).
9. Proshare Tier 1 Banks Report 2024: Access Corp, Zenith Bank, FBNH Lead in PBSI Ranking.
10. CBN Revokes Heritage Bank's Licence, NDIC Takes Over Liquidation as Banking Supervision Comes Under Scrutiny.
11. Nigeria's Banking Recapitalisation: A Crucial Game, A Risky Gamble, and A Lingering Gap.
12. Analyst Perspective on the 2024-2026 Nigerian Banking Recapitalization Exercise.
13. GCR Places FCMB Group Plc's National Scale Long and Short-term Issuer Ratings of BBB+(NG)/A2(NG) on Review Extension.
14. FCMB Capital Markets Wins NGX Award for Most Listed Debt Issuances in Nigeria.
15. FCMB Group Plc Reports 108% YoY Growth in PBT in 9M 2023.
16. FCMB Group Plc Announces Issuance of N26bn Series 2 Perpetual 16.00% Fixed Rate Resettable NC5.25 Additional Tier 1 Subordinated Bonds Under the N300bn Debt Issuance Programme.
17. Terra Academy for the Arts (TAFTA) Partners with FCMB Bank to Offer Soft Loans Supporting the Creative Industry.
18. Fitch Places FCMB on Rating Watch Negative on Naira Devaluation; Affirms 7 Other Nigerian Banks.
19. FCMB Group Plc Declares N31.13bn PAT in 2022 Audited Results; Proposes 25k Final Dividend,(SP:N4.15k).

Advice To Users of This Report.

Proshare, founded in 2006, is a trusted professional practice and financial information hub dedicated to serving as a critical bridge between the markets, investors, regulators, and stakeholders. By delivering credible, reliable, and timely engagements, we assist the marketplace to shape thought-led conversations premised on evidence-based insights that hold the firm accountable collaboratively.

Practice Ethos and Disclaimer

Proshare does not guarantee any results or investment returns based on the information contained in this report. Although we have used our best efforts to provide the most accurate information, we do not promise verbally or in writing that you will earn a profit when or if you use the information contained therein and/or take the actions that might have been prescribed here by the author or our analysts, any reliance you place on our content for decision making is at your own risk Reports often contain complex technical language, kindly seek expert analysis or expert opinions to help interpret the findings accurately. Context is key, and understanding is essential to grasp the report's true implications. We encourage our discerning readers to seek additional education and insights as you navigate the complexities of the report. As consumers of news and information, we play a role in responsible reporting, be cautious of spreading unverified or misleading information about the report's contents or corporate entities mentioned in the report.

Creation Date

This report was published on August 07, 2024, and is based on the best publicly available information at that time. The PDF version was created on August 07, 2024. For comments, feedback, and updates, kindly send us an e-mail via **research@proshare.co**. Thank you.

Teslim SHITTA-BEY
Managing Editor/CE

Tosin IGE
Head, Research

Market Intelligence. | **Impact Research.** | **Digital Media.** | **Strategic Advisory.** | **Stakeholder Relations.**

Contacts.

Olufemi **AWOYEMI**, *mni*
ceo@proshare.co

Teslim **SHITTA-BEY**
teslim.bey@proshare.co

Tosin **IGE**
research@Proshare.co

Ademidun **SHOGO**
ireconomist@Proshare.co

www.proshare.co
+234 902 407 5284
@proshare
proshare.co
proshare.co
proshare.co

Plot 590b, Lekan Asuni
Close, Off Toyin Omotosho Street,
Omole Phase 2, Isheri Olowora
Ikeja, Lagos, Nigeria **PC: 105102**
Tel: **0700 – PROSHARE**
E-mail: info@proshare.co