



CORONATION

MERCHANT BANK

# Year Ahead 2020

Re-risking the financial system



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## Re-risking the financial system

**Oil prices.** In a global oil market threatened with over-supply, it appears that OPEC, and its ally Russia, are doing a good job of limiting production. Oil price volatility was reduced in 2019 and prices (Brent) held up above US\$60.00/bbl most of the time. With further OPEC cuts announced last December, we think 2020 may well be a repeat performance. The current futures curve supports this view. We look for oil to average at least US\$60.00/bbl this year.

Due to oil's role in a) supplying US dollars to the Central Bank of Nigeria (CBN), and b) inspiring confidence in Nigerian markets generally, this outlook forms an integral part of our foreign exchange and interest rate view. We believe that oil prices below US\$50.00/bbl, for example, could challenge foreign exchange and interest rate management.

**Foreign exchange.** We expect that the CBN will keep the exchange rate at close to N362.50/US\$1 for most, if not all, of 2020. Although foreign exchange reserves fell steeply during the second half of 2019, we believe there will be sufficient sources of US dollars in 2020 for the CBN to support FX reserves. These include possible issues of eurobonds and international loans. Important data points, in this regard, will be the level of foreign portfolio investment (FPI) in the CBN's open market operation (OMO) bills during January and February 2020. If this resumes in earnest then the pressure on FX reserves will ease considerably, in our view.

**Interest rates.** We expect downward pressure on T-bill and government bond rates to continue as domestic funds rotate from high-yielding CBN OMO bills into government securities. However, there are two disruptive forces at work, we believe, which could change the interest rate outlook.

**Possible change in interest rate regime.** First, it is not certain that foreign portfolio investors will return to buy the CBN's OMO bills in early 2020. Second, Naira T-bill yields are close to yields on Nigeria's sovereign US dollar eurobonds, so demand for US dollars may increase. If FX reserves fall quickly (for example, as fast as they did during H2 2019), we could see a reversal of interest rate policy, opening the way for T-bill rates to rise.

**Bank stocks, and earnings.** This time last year we argued that bank valuations were low but that a catalyst was required. This year we cannot complain about the catalyst. T-bill yields have fallen far below, in some cases half the level of, the gross dividend yields of several listed banks. Hence our continued Buy recommendations. Bank earnings may suffer somewhat from the CBN's initiative to limit the scope of card charges: but this will likely be offset by balance sheet expansion and a degree of interest rate protection from high-yielding securities, in our view.

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# Oil prices

## US\$60.00/bbl or above is in prospect

Oil prices look set to trade above US\$60.00/bbl for most of 2020f, in our view, with the potential to soothe investors' fears about Nigeria's outlook.

Continued OPEC cuts, led by Saudi Arabia, are supporting the forward curve which prices oil (Brent) at US\$62.00/bbl in mid-2020.

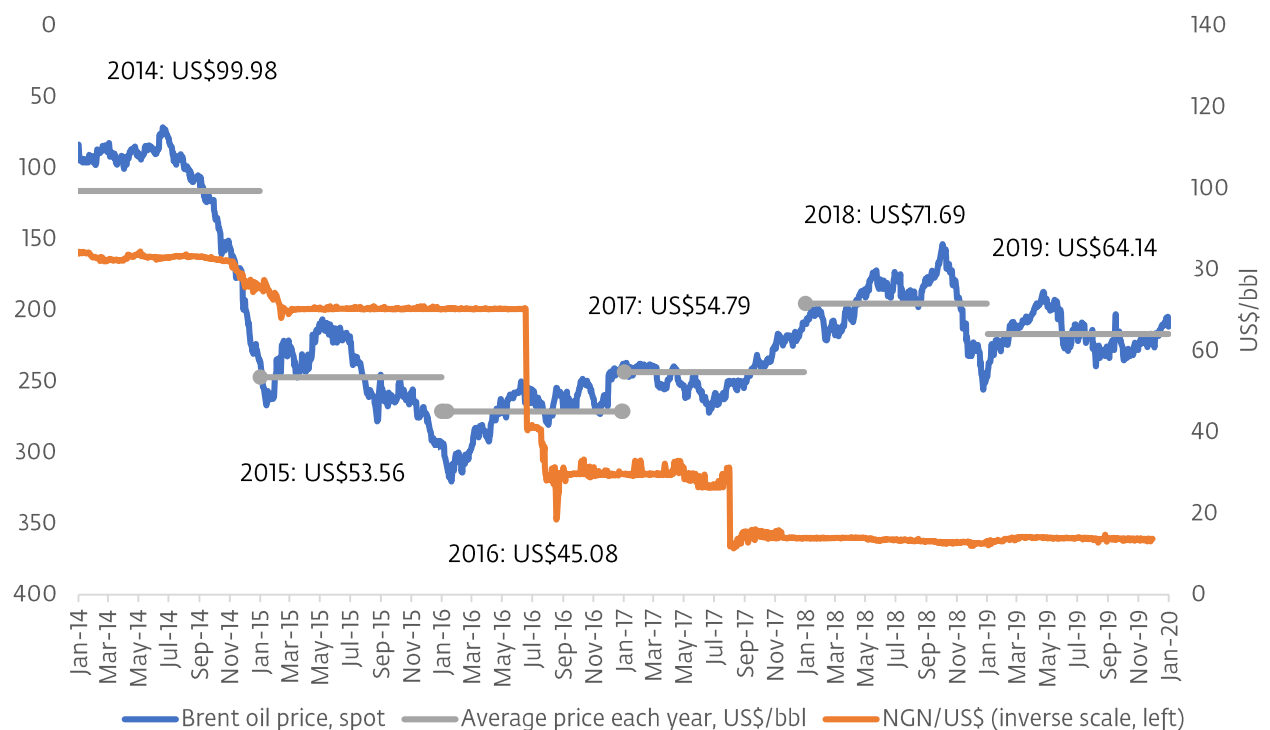
OPEC may insist on Nigeria sticking to a quota of 1.75 million barrels per day (mbpd) production, a 7.00% reduction from recent levels of 1.89mbpd. This challenges assumptions made in the 2020 budget.

Our core thesis is that portfolio investors (both domestic and international) are confident about Nigeria's prospects when oil prices (Brent) are close to US\$60.00/bbl or above, and unhappy when oil prices fall below this level. 2019 was a case in point, when markets were generally happy with Nigeria's profile but responded negatively to oil falling to US\$56.22/bbl in early August – net outflows of US dollars from the reserves of the Central Bank of Nigeria (CBN) rose that month, as did domestic interest rates around that time.

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### Oil prices (Brent) and NGN/US\$ exchange rate (inverted scale, lhs)

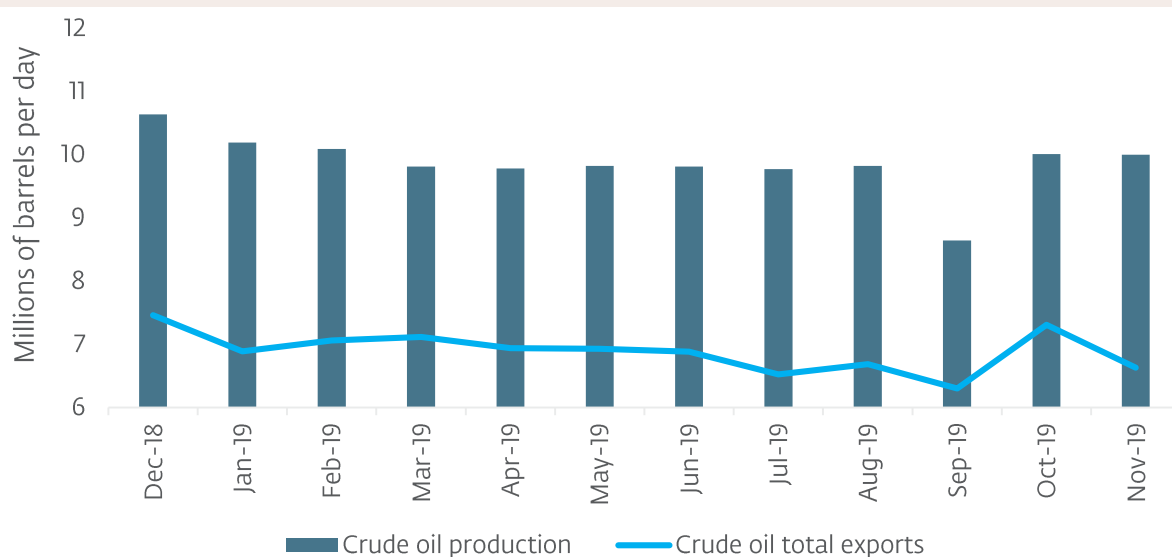


Source: Bloomberg, Coronation Research. NB. For currency forecast see Naira foreign exchange outlook 2020

# Oil prices in 2020

But 2019, on the whole, was a good year for Nigeria in terms of oil prices. The range of oil prices in 2019 (high US\$74.53/bbl: low US\$56.22/bbl) was narrower than in 2018 (high US\$85.00/bbl: low US\$50.47/bbl) and overall volatility was lower. The average price during 2019 was US\$64.04/bbl, 10.67% lower than in 2018, but still above the important US\$60.00/bbl level. In these circumstances questions about commodity price disruption to Nigeria’s prospects were seldom heard. It also helped that Nigerian oil production rose during the year, at least from January through to August when it reached 1.95 million barrels per day (mbpd).

## Saudi Arabia moderates oil production



Source: Bloomberg, Coronation Research

What of 2020? We are, to summarise our view, confident that oil prices can hold at or above US\$60.00/bbl for most of 2020. We point to three factors.

The first is that, during 2019, production cuts initiated by the Organization of the Petroleum Exporting Countries (OPEC), plus its close ally Russia, had positive effects. And OPEC resolved to deepen these cuts at its 5-6 December 2019 meeting. Although OPEC’s global market share is falling, it nevertheless remains influential, and it has proven capable of removing much of the price volatility which we saw during 2016 and 2017. We examine its influence on Nigerian oil production below.

Second, and partly as the result of production cuts, the forward curve in oil prices (Brent) is showing values above US\$60.00/bbl for all of 2020, as indeed it was one year ago (which gave us comfort at that time). Much oil production is sold between three and six months forward, in any case.

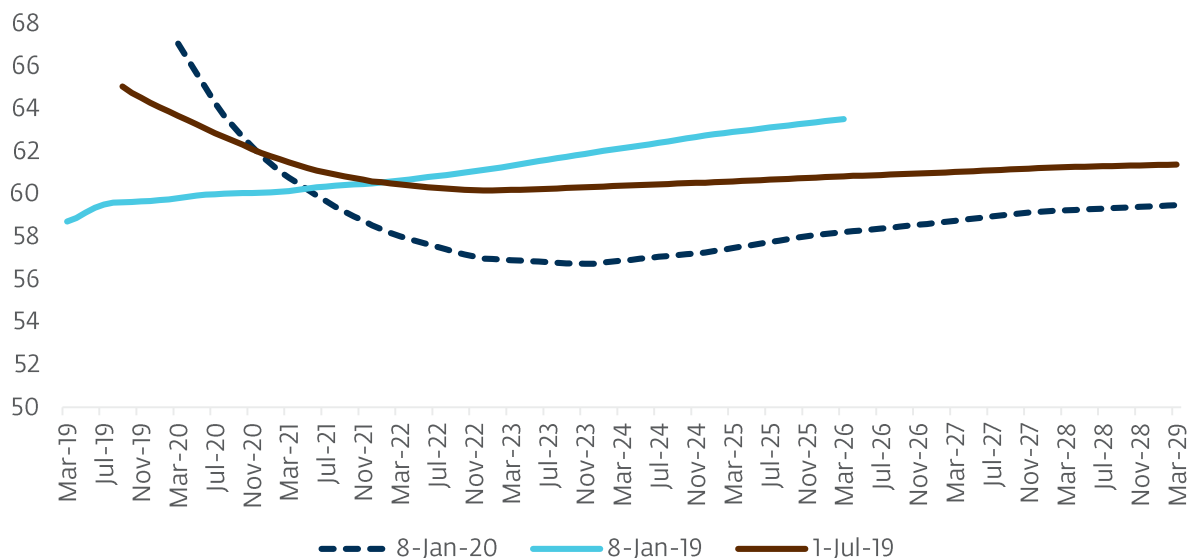
Third, 2020 began with a significant deterioration in relations between the USA and Iran, and such tensions in the Gulf region have a habit of driving prices upwards (though not always for long – last September’s bombing of a Saudi Arabian oil facility only prompted a brief spike in prices). Our view is that there could be further episodes of tension in the Gulf region in the year ahead and that the risk premium may again become elevated at some point, or points, during 2020.

Against this, ongoing trade tensions between the USA and China pose continued risks to global growth and global oil demand. This has been a threat for many years, however, and it is important to note that both the IMF and the World Bank still forecast that the world will be growing in 2020.

# Oil prices in 2020

There are many other areas of uncertainty; among them production levels from Venezuela, Iraq and Libya, all of which can be considered wild cards though OPEC members. But the overall dynamic of a growing global economy, and the ability of OPEC and its ally Russia to moderate production levels, suggests a baseline of price stability, possibly supported by the risk premium coming from the Gulf.

Oil (Brent) futures curve, US\$/bbl



Source: Bloomberg, Coronation Research

## What oil prices mean for Nigeria

For Nigeria in 2020, in our view, the two critical prospects are prices generally above US\$60.00/bbl and absence of extreme corrections below US\$60.00/bbl (even if these are temporary). As the chart on the first page of this section shows, Naira devaluations in 2016 and 2017 were preceded by sharp falls in oil prices in late 2014, throughout 2015 and on into the first quarter of 2016. Investors in Nigeria become nervous when oil price corrections are sustained.

This is not to say that oil price corrections cause Naira devaluations – we think that inflation differentials between the Naira and the US dollar are the ultimate cause, and that periodic shortages of FX reserves at the CBN are the immediate causes – but oil price corrections both undermine investor confidence and, to an extent, reduce inflows of US dollars to the CBN’s reserves.

Oil & gas is not, as some suppose, the largest part of the Nigerian economy. It accounted for 8.00% of GDP in 2018 and 9.77% of GDP in Q3 2019 as production grew during the first nine months of the year. Oil & gas, however, does account for more than 80% of Nigeria’s exports, and is a significant source of US dollars to the FX reserves of the CBN. In the first nine months of 2019 Nigeria’s trade account in goods, thanks to exports of oil & gas, stood at a positive US\$7.77bn (though, thanks to debt service payments and purchases of invisible items, Nigeria’s current account in the first nine months of 2019 stood at negative US\$9.10bn). Revenues from oil & gas contribute upwards of 60.00% of government revenues. Therefore, the level of oil & gas production, as it is affected by OPEC quotas, is important to government revenues.

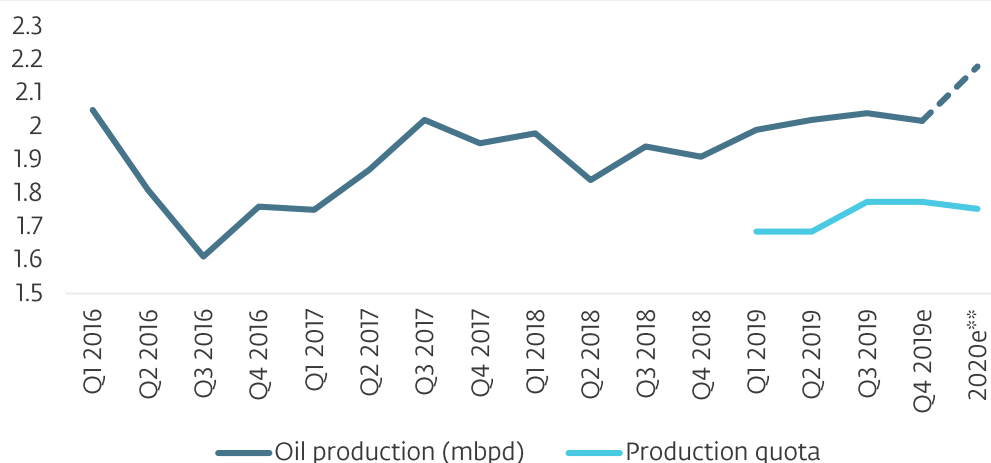
## What OPEC cuts mean for Nigeria

The 14 member countries of the Organization of the Petroleum Exporting Countries (OPEC) met in Vienna on 5-6 December and agreed on an additional 500,000 bpd cuts over what had been agreed before. This put the total scheduled production cuts from the cartel at 1.7 million bpd during 2019.

OPEC produces about 30.0% (29.7mbpd) of global oil supply, which is 2.6mbpd fewer than a year ago. A little less than half of that reduction comes from agreements within OPEC, with the rest of the shortfall attributable to difficulties experienced by OPEC members Venezuela and Iran. In the past, Saudi Arabia has done most of the heavy lifting in curbing the supply glut by over-complying with its quota of 10.3 million bpd and producing on average, 9.8 million bpd during most of 2019. The kingdom recently pledged an additional 400,000bpd supply cut.

A major concern for the cartel is to enforce compliance by member countries. Iraq and Nigeria have notoriously produced far in excess of their respective quotas, in some cases citing previous under-production as reasons to compensate later.

### Nigerian oil production vs OPEC quota, mbpd\*



Source: Central Bank of Nigeria, Coronation Research. \*million barrels per day. Q4 2019 was estimated as an average of the first three quarters of 2019. N.B. the dotted line shows government's projection of oil production in 2020.

On the supply side of the equation, Nigeria's current production quota is 1.77mbpd and the most recent cuts allots 21 thousand barrels per day as Nigeria's share of the overall cut. Effective 1 January 2020, this brings Nigeria's new production quota to 1.75mbpd. This is 6.41% lower than the recent (November 2019) production level of 1.87mbpd.

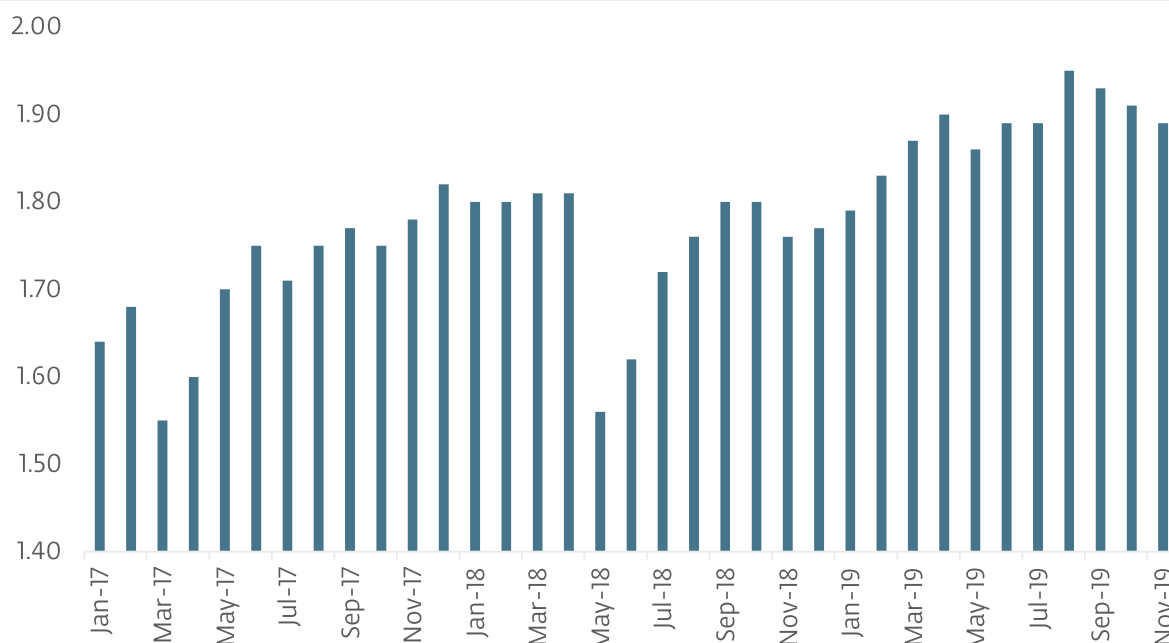
### Oil and the government budget

The Federal Government of Nigeria (FGN) budget for 2020 is for N10.59 trillion (tn), or US\$29.25bn at market exchange rates. In 2019 the budget was N8.92tn (US\$24.64bn). The 2020 budget assumes an oil price of US\$57.00/bbl (the 2019 assumption was US\$60.00/bbl) and average daily production of 2.18mbpd (the 2019 assumption was 2.30mbpd). It seems likely, therefore, that the FGN may be disappointed somewhat in 2020f.

# Oil production

A feature of FGN budgets is to project levels of oil production in excess of both OPEC quotas and actual historical averages. For example, the projected output for 2019 was, as stated above, 2.30mbpd when in 2018 it had averaged 1.75mbpd (and in 2017 1.71mbpd). In the first eleven months of 2019 production averaged 1.88mbpd in comparison with the budget's projection of 2.18mbpd for 2020.

Nigerian oil production, mbpd



Source: Bloomberg, Coronation Research

The result is that oil revenues are often lower than budgeted, unless prices turn out to be far above the budgeted level. Average production in 2019, while it was approximately 18.00% lower than the 2.30mbpd budgeted, at least benefited from the deployment of Total's Egina field which has a total capacity to pump 200,000mbpd and was rolled out during the year. And average oil prices in 2019 were some 7.00% above budgeted US\$60.00/bbl.

## A note on using oil prices

The relationship between the gross output of the oil & gas industry and the revenues it supplies to the Federation Account is far from simple. For example, realised prices of Nigerian oil differ slightly from Brent so that West Africa Bonny Light, for example, trades at a premium to Brent, usually in a range of US\$0.50/bbl to US\$2.50/bbl. Shipments typically are sold three or more months forward. The Nigerian National Petroleum Corporation (NNPC) receives revenue from its joint-venture shares in exploration, but is obliged to pay operating and capital expenditure in joint venture cash calls. The FGN also receives revenues from oil company taxation. In recent years the NNPC has settled back-payments of cash calls, in some cases by taking loans from commercial banks serviced with first-line deductions from its revenues. Gas revenues are complex to model as gas tends to be a contract business as much as it is a commodity business.



# Naira exchange rate outlook 2020

A stable Naira/US dollar exchange rates but risks are rising

In the long term the Naira depreciates against the US dollar in line with the difference in inflation between the two currencies. Trying to stop the Naira from depreciating has proven a forlorn activity.

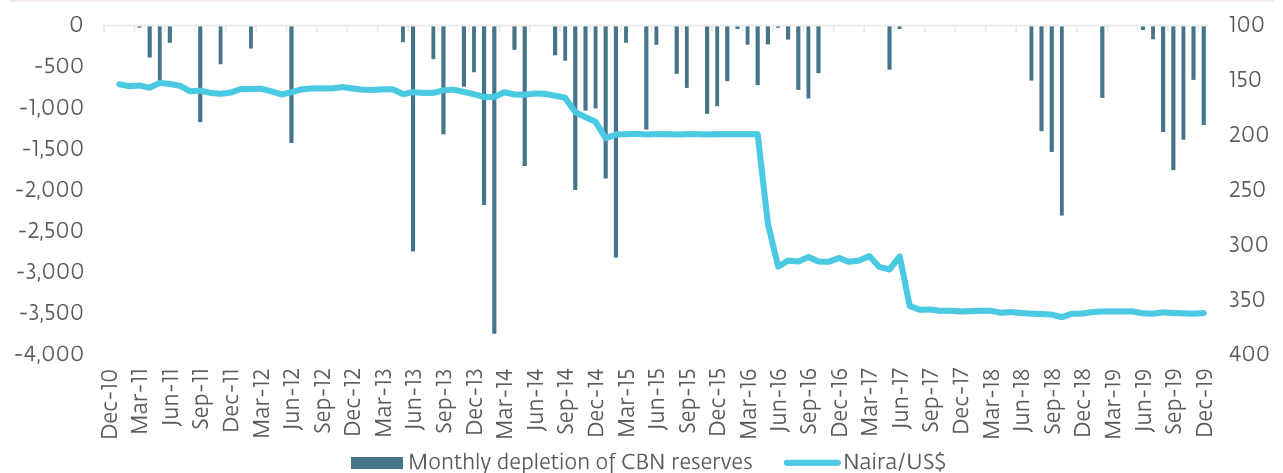
We believe the CBN will keep the exchange rate at close to N362.50/US\$1 for most, if not all, of 2020. But the effect will be to add pressure on the Naira as its fair value slips against the US dollar.

The recent history of the Naira/US dollar exchange rate shows that 20% over-valuation of the Naira, in terms of fair value, is associated with devaluation. Such a level may be reached during 2021, but the risks of this in happening in 2020 are low, we believe.

The immediate cause of Naira devaluation (as opposed to the long-term driver) is unsatisfied demand for US dollars and resulting depletion of foreign exchange (FX) reserves at the CBN, as we observed in 2016. From this perspective a gross foreign exchange reserve level of US\$30bn or less has proven dangerous as it restricts the ability of the CBN to supply US\$ to the FX market. The chart on this page shows several periods of depletion of CBN FX reserves – it entered into such a phase in H2 2019.

Management of FX reserves is linked to the CBN's setting of market interest rates. Currently Nigeria has a dual interest rate system, with the CBN's open market operation (OMO) bills available only to banks' proprietary books and to foreign portfolio investment (FPI). The latter accounts for a significant proportion of the CBN's US\$38bn FX reserves. If the CBN cannot sell sufficient OMO bills to foreigners in early 2020 then this could, in our view, present challenges to its FX reserve management and disrupt the current N362.50/US\$ exchange rate.

Monthly outflows of CBN FX reserves, US\$m (left) and NGN/US\$ (interbank)



Source: CBN, Bloomberg, Coronation Research \*derived from 3-month MA data NB only negative moves in CBN reserves feature in this chart

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# Fair value (1/2)

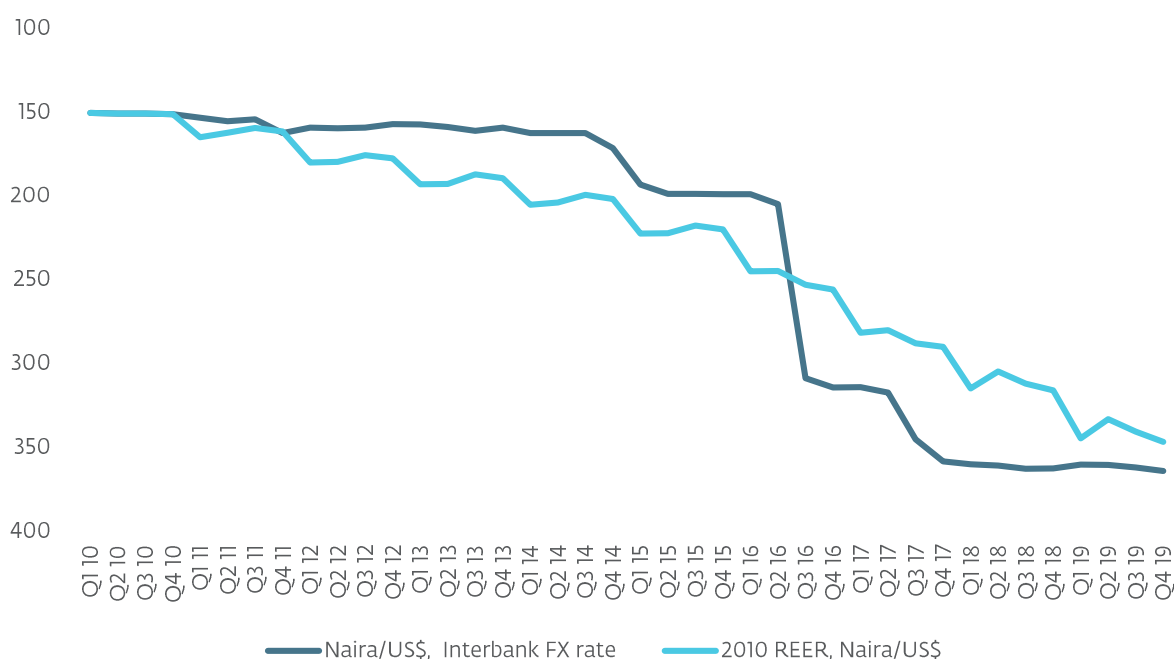
## Risks to our exchange rate view

The results of OMO bill sales to foreign portfolio investors during January and February 2020 will provide an important indicator of whether the CBN's FX reserve management is succeeding. Foreign investors may find OMO yields (currently 14.92% per annum) attractive, but could be deterred by the recent decline in liquidity in the OMO market (see *Interest Rate Outlook, 2020*). Other risks to our view of a stable exchange rate come from oil prices, which could fall below the important US\$60.00/bbl level, and from the ongoing P&ID court action, which we discuss below. Demand for US dollars, given the proximity of Naira T-bill rates with Nigerian sovereign US dollar eurobond rates, could increase as some investors will likely prefer to hold the latter. Such a rise in demand for US dollars could ultimately put pressure on the CBN's FX reserves.

## Fair values range from 4.4% undervaluation to 13.4% overvaluation

Our interest in fair value measures of the Naira derives from the similar performance of fair values and actual exchange rates over the past nine years. The difference between fair and actual values is that changes in fair value are regular (derived from inflation data) while actual values hold steady for long periods before periodically lurching downwards through devaluation. Inflation in Nigeria (November 2019: 11.85% y/y) is much higher than in the US (November 2019: 2.05% y/y).

Naira/US\$ (interbank) and REER Naira/US\$



Source: CBN, Bloomberg, Coronation Research

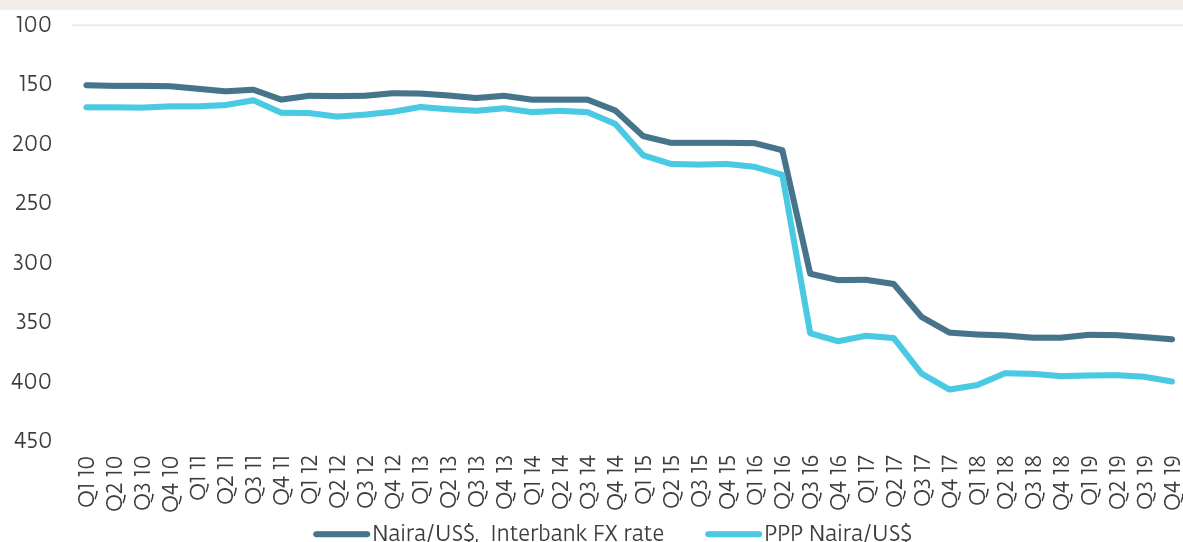
The idea behind the fair value measure is that goods and services are priced at rising Naira prices each year. If the Naira/US dollar exchange rate does not adjust, then goods and services become increasingly expensive in US dollars. The cumulative inflation differential then makes the Naira appear expensive to the US dollar.

We use three measures of fair value here. The first is the real effective exchange rate (REER). This measure, unlike the other two, gives a fair value higher than the current exchange rate, namely N346.69/US\$1, 4.36% stronger than the current N362.50/US\$1.

## Fair value (2/2)

Our second measure in the Purchasing Power Parity (PPP) method. This suggests a fair value of N399.44/US\$1, or 13.21% lower than the current exchange rate.

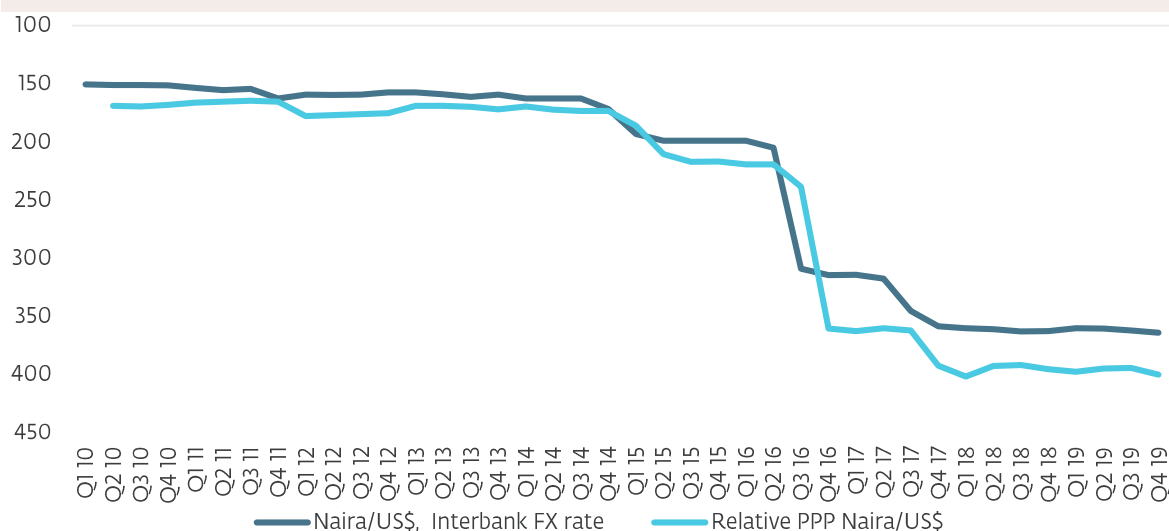
### Naira/US\$ (interbank) and PPP Naira/US\$



Source: CBN, Bloomberg, Coronation Research

Our third method, the Relative Purchasing Power Parity PPP (Relative PPP) method, suggests a fair value of N400.11/US\$1, or 13.35% lower than the current exchange rate.

### Naira/US\$ (interbank) and Relative PPP Naira/US\$



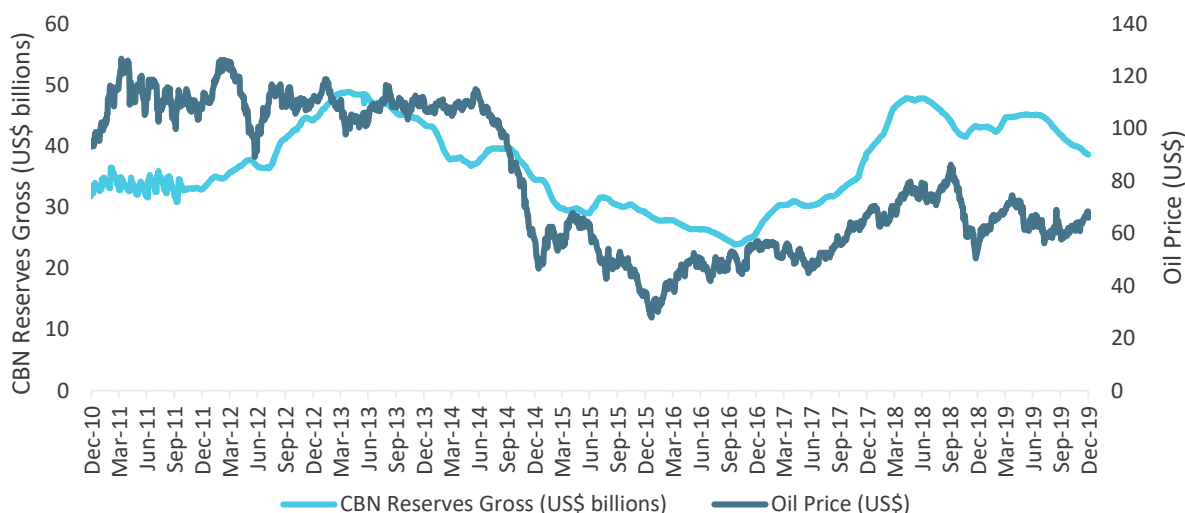
Source: CBN, Bloomberg, Coronation Research

The last two fair value measures may not seem very large, but we view them as highly significant. If, as we think, the CBN will hold the exchange rate at close to N362.50/US\$1 for 2020, then these fair values (assuming that Naira inflation remains some nine or 10 percentage points higher than US inflation) will likely be around 20% lower than the actual exchange rate by the end of 2020. 20% variance from the actual exchange rate (as in 2016) is associated with devaluation. This, in our view, points to mounting pressure during 2021.

# The balance of CBN US dollar flows (1/2)

Given that the CBN acts as a backstop provider of US dollars to Nigeria's FX markets, it is necessary to assess the health of its own US dollar inflows. Some of these are derived from oil revenues. Oil prices at or above US\$60.00/bbl are, over the long term, associated with healthy (i.e. above US\$30.00bn) levels of CBN gross reserves.

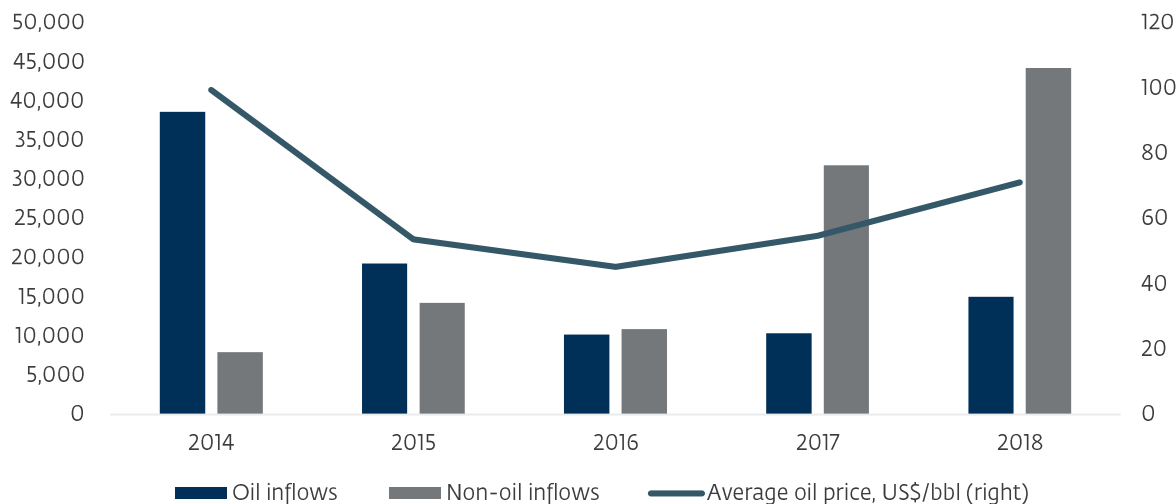
CBN Gross Reserves, US\$bn (left) and oil prices, US\$/bbl



Source: CBN, Bloomberg, Coronation Research

However, over the past five years oil & gas-related inflows into the CBN have become less important in relation to non-oil inflows. Non-oil inflows range from FPI purchases of CBN OMO bills, FPI purchases of T-bills and government bonds, to government receipt of sovereign Eurobond and other foreign loan proceeds, among other sources.

Oil and non-oil inflows to the CBN, US\$m, and average oil prices (right), US\$/bbl



Source: CBN, Bloomberg, Coronation Research

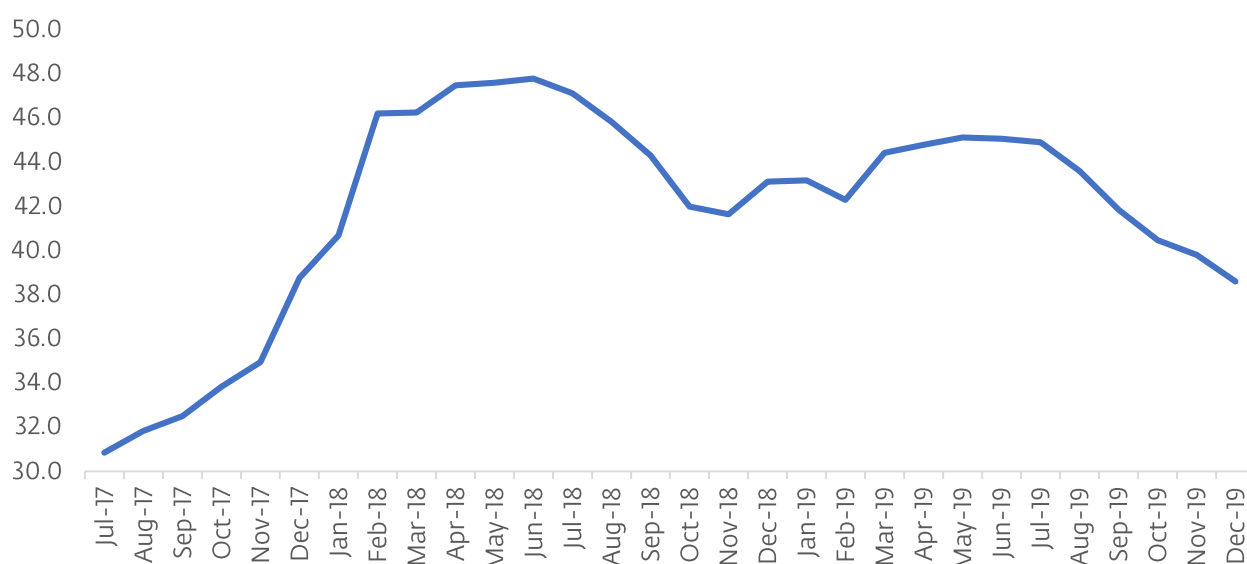
We do not yet have the breakdown of CBN US dollar inflows for 2019. The trend from 2014-18, however, shows a rising level of non-oil inflows. Many of these relate to borrowing from foreign sources.

## The balance of CBN US dollar flows (2/2)

Therefore, assessing the likely flow of debt issuance to foreign counterparties during 2020 (whether issued by the CBN or the Federal Government of Nigeria, FGN) is critical to assessing the balance of US dollar inflows to the CBN in 2020. In 2019 inflows benefited immensely from the reversal of US interest policy at the end of January (US rates have fallen by 75bps since then) which prompted FPI to return to the carry trade (short US dollar / long Naira). In the first half of 2019 the average monthly increase of published CBN reserves (a monthly moving average) was US\$325.4m: but in H2 there was an average monthly outflow, using this measure, of US\$1.1bn.

An average monthly outflow of US\$1.1bn could not be sustained in 2020 (not even for the duration of the first half of 2020) without causing a challenging depletion of CBN FX reserves, in our view. On the other hand, we have reasons to think that the trajectory will likely be somewhat better than that. First, having not issued a sovereign Eurobond in 2019, Nigeria may be able to sell several US\$ billions of Eurobonds in 2020. Second, Nigeria is likely to continue to draw down in 2020 tranches of a US\$3.0bn loan agreed last year with the World Bank.

CBN FX reserves, US\$bn



Source: CBN, Coronation Research

Third, foreign portfolio investors may well return to purchasing the CBN's OMO bills in January and February, as mentioned above (also, see Interest rate outlook 2020, page 18). The behaviour of traders in foreign funds needs to be understood. Having tailored their portfolios to close books in December, traders typically wait to be paid their bonuses in January or February, before figuring out how to repeat their financial performance in the following year. We must wait until early March to see whether the CBN's offerings of OMO paper to FPIs are being taken up.

Against this, we recognise the burden of debt service liabilities and the fact that the CBN will likely continue to supply US dollars to the FX markets when required, in order to prevent participants driving down the Naira in the parallel FX market (as happened in 2016 and 2017). The CBN's gross supply of US dollars to the Nigerian Autonomous Foreign Exchange (NAFEX) market in H2 2019 was US\$5.18bn.

## Eurobonds, and threats

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As mentioned above, Nigeria did not access the Eurobond markets in 2019 despite the fact that it is a frequent and usually welcome participant. The Debt Management Office (DMO) of the FGN has recently disclosed that it wishes to access the market during 2020 though it is not clear what volumes are being considered. The DMO's overall target for foreign currency funding in 2020 is approximately US\$2.8bn. Nigeria's sovereign eurobond rates are discussed and shown in the 'Interest rate outlook 2020' section.

### Process and Industrial Development (P&ID)

The Cayman Islands-registered company Process and Industrial Development (P&ID) has won several court judgements in England with respect to its approximately US\$9.0bn claim against the Federal Republic of Nigeria (FRN). Details of the case are discussed in Coronation Research, *P&ID's Risk to Nigeria*, 14 March 2019, since when P&ID has made some progress in the High Court of Justice in London. Needless to say, and given the significant size of the claim, lawyers for the Federal Government of Nigeria (FGN) are contesting the claim both in the courts in London and in the USA, where P&ID has also sought to have its claim enforced.

The risk, in our view, is that P&ID could at some stage enforce its claim against the FRN in 2020 (although not directly against the CBN which is an independent national bank and therefore not part of the FGN). This could bring a measure of disruption to Nigerian financial markets.

# Interest rate outlook

## Experiment in 2019: what results in 2020?

### An experiment in three parts

In the second half of 2019 the CBN embarked on a venture in monetary policy with three distinct parts: Nigerian banks were required to meet minimum levels of lending (the loan-to-deposit, LDR, targets); it banned domestic institutions from buying new issues of its open market operation (OMO) bills (when the OMO market was several times the size of the T-bill market); and, in order to help foreign investors, it established its own trading facility in OMO bills. (OMO bills used to be traded between foreign and domestic institutions, and were effectively fungible with T-bills.)

### The immediate results

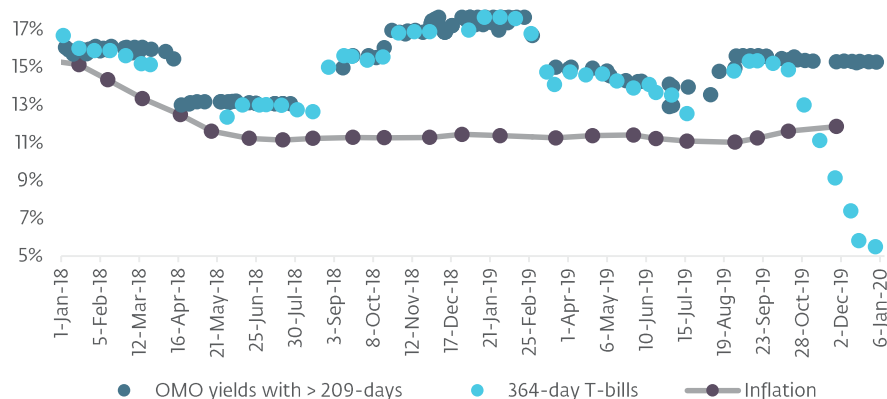
The immediate results have been dramatic; the CBN might well congratulate itself on having achieved several objectives. Private sector credit grew in Q3 (we await Q4 data). T-bill rates fell sharply (see chart) and, since T-bill rates are a reference for both loans and deposits, the cost of loans also fell (with banks racing to re-price deposits). The economy grew faster in Q3 than it had in Q2 (again, we await Q4 data). A government-inspired policy in H2 2019, the closure of land borders, may also stimulate agriculture (25% of GDP) and manufacturing.

### And a few headaches

Foreign investors are still allowed to buy high-yielding OMO bills. As outlined in the Naira exchange rate outlook, 2020 section, a key question is whether foreign portfolio investment will return to buy new OMO bills in 2020. This question will be answered when we see (in early February, and then in early March) FPI data for January and February. On this outcome depends the future of the CBN's interest rate policy, in our view.

At the same time domestic fixed income investors are now faced with Naira-denominated T-bills yielding much the same as US dollar-denominated sovereign Eurobonds. This itself may stimulate investment demand for US dollars – something we reason the CBN does not want.

### Yields on primary OMO bills and T-bills at auction, and inflation



Source: CBN, NBS, FMDQ, Coronation Research

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# Changes in investors' behaviour

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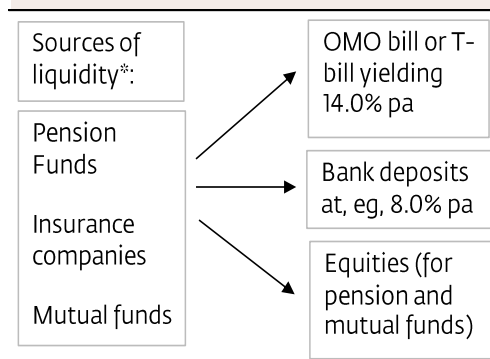
## Domestic investors have fewer choices than before

CBN policies enacted since June 2019 are having far-reaching effects on the behaviour of liquidity managers in Nigeria and on the activities of banks.

To summarise the changes in CBN monetary policy in the second half of 2019: in July the CBN introduced a minimum loan-to-deposit (LDR) ratio for banks of 60%, enforceable at the end of September, and 65% enforceable at the end of December; in late October the CBN stopped domestic institutional and corporate investors from buying its open market operation (OMO) bills, though Nigerian banks are still allowed to buy OMO bills for their proprietary (non-customer) positions; the CBN later set up a facility to trade OMO bills with foreign institutional investors.

The CBN's intention is to stimulate economic growth by encouraging banks to make customer loans, and to prevent that liquidity returning to its own OMO bills. As detailed below, private sector credit grew in Q3 2019, after a long period when it had stagnated. And we expect it to have grown significantly in Q4 2019. GDP growth was 2.28% in Q3 2019 after 2.12% (restated) in Q2 2019. And there are reasons to think that it would have improved further in Q4 2019.

### Simplified flow diagram of liquid Naira-denominated investment choices for institutional investors, mid-October 2019



Source: Coronation Research \*Non-bank sources of liquidity NB, OMO bills were available until 24 October

In the diagram above we present a simplified view of the available liquid asset classes available to Nigerian institutional investors for many years in the run-up to October 2019. Two critical aspects of the Naira-denominated risk-free investment universe prior to late October 2019 were as follows:

1. The OMO bill market was at least six times larger than the T-bill market. The volume of OMO bills outstanding last October was N14.5tn (US\$40.2bn) while the total volume of T-bills outstanding was N2.2tn (US\$6.1bn). For comparison, Nigeria pension funds, under the management of pension fund administrators (PFA), held assets worth a total of N9.6tn (US\$26.6bn) at the end of September 2019;
2. OMO-bills and T-bills traded as fungible instruments allowing investors to adjust maturities and realise gains. This was important to foreign portfolio investors in OMO bills, in our view.

It therefore follows that, after the ban in late October on Nigerian corporates (including pension and mutual funds) from buying OMO bills, money rotated from the OMO bill market to the T-bill market and pushed down T-bill rates sharply.



# Changes in banks' behaviour

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## Changes in investors' activity directly affect banks

How have the changes in domestic investor behaviour affected banks? The short answer is 'profoundly'. But before we go into the details, it is important to emphasise a key aspect of the CBN's regime since late October 2019, namely that two classes of investor may continue to invest in its OMO bills. These are:

1. Foreign portfolio investors;
2. Banks' proprietary books. Banks continue to invest in OMO bills.

From the above, it is possible to deduce how banks react to: a) being instructed to raise the level of loans they hold relative to their deposits; and b) being allowed to hold OMO bills as proprietary assets. They have a strong incentive to make low-priced loans while receiving a degree of margin protection from the small amount of funds which they are still allowed to invest in OMO bills. (The amount is small because banks must still lodge zero-interest-bearing funds with the CBN under the 22.5% cash reserve requirement.)

The behaviour of banks adapted rapidly to the new regulatory environment. As the chart on the next page shows, the imposition of the minimum loan-to-deposit (LDR) ratio of 60% with a deadline of 30 September 2019 raised the aggregate level of customer lending in Q3 of last year. We believe that when we see the data for private credit for Q4 2019, it will show a further and significant advance, given the increase in the required LDR ratio to 65% effective 31 December 2019.

## Cost of borrowing falls sharply

Loan rates have been falling. Commercial bankers we have spoken with talk of a rapid re-pricing of loans during Q3 and Q4 2019 (and they have tried to cut deposit rates to match). Cuts in lending rates in the region of 400 basis points (4.0%) over the past few months have not been unusual.

From the point of view of issuers of debt, the changes were well-received. The corporate commercial paper (CP) market was reinvigorated, with several large corporates entering the market with issues priced at close to the prevailing T-bill rate. The effect of rate cuts fell, naturally enough, at the short end (e.g. one-year) of the Naira interest rate curve, but there was tightening at the mid-range (e.g. five-year) and long end (e.g. 10-year) of the curve too, which opened up the possibility of companies issuing Naira-denominated bonds as well.

At any rate, the benefits of current CBN policy are weighted towards issuers, with domestic asset managers faced with the difficult question of where to find yield: November 2019 inflation was 11.85% y/y.

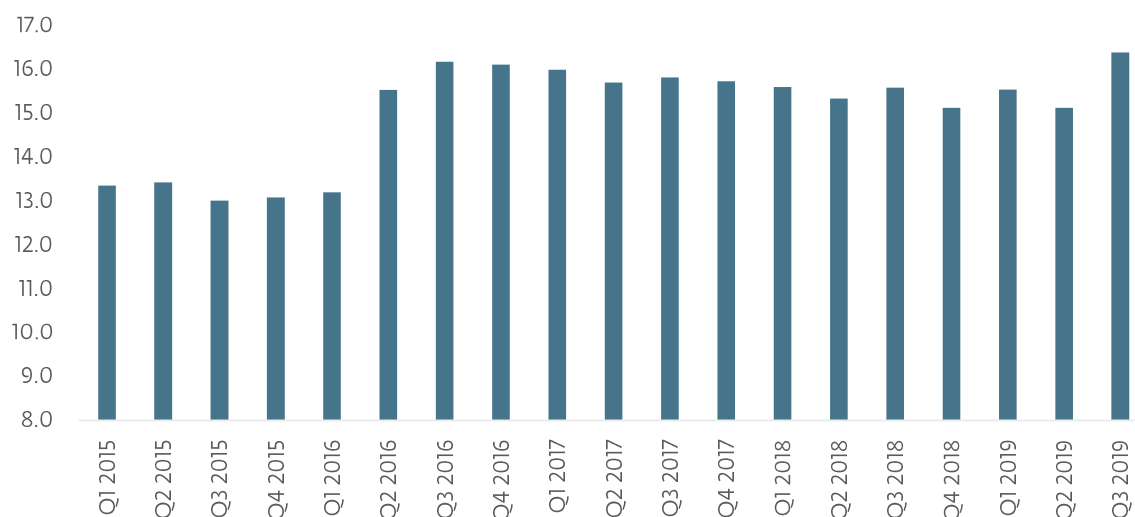
# Credit rises, interest rates fall

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## The volume of customer loans rises

After the imposition of the 60.0% minimum loan-to-deposit rule in July 2019 private sector credit grew to N16.397tn (US\$45.4bn) at the end of September, 8.4% higher than its mid-year level. Before this, private sector credit had been static. It was N15.134tn (US\$42.0bn) at Q4 2018 and N15.133tn at H1 2019. We expect it to have grown again in Q4 2019.

### Private sector credit, Naira trillions

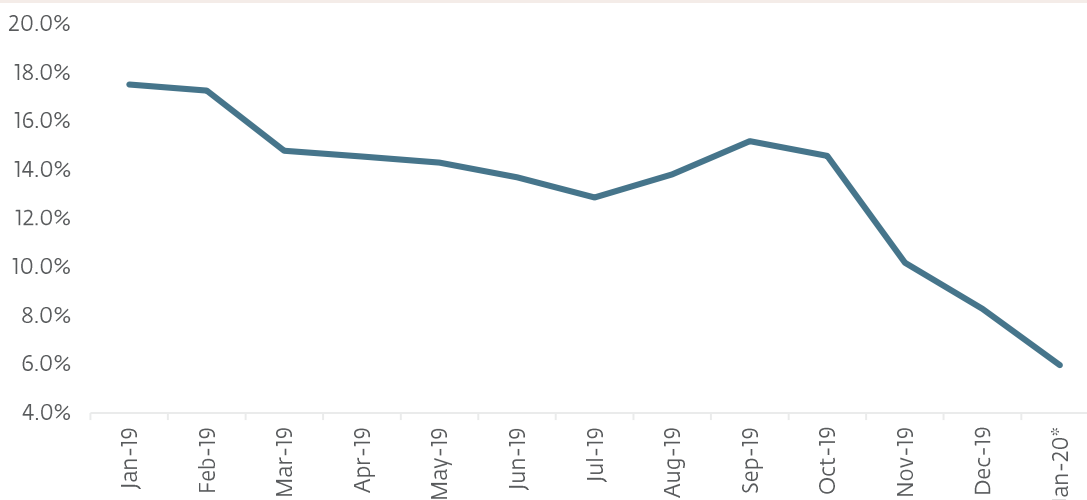


Source: Central Bank of Nigeria, Coronation Research

## Bond rates and T-bill rates fall

Meanwhile, the transfer of domestic institutional managed money from the large OMO bill market to the small T-bill market has been pushing T-bill rates down.

### Average Secondary Market T-bill rates



Source: Financial Markets Dealers Quotations (FMDQ), Coronation Research \*8 January 2020

# Foreign investors' reactions (1/2)

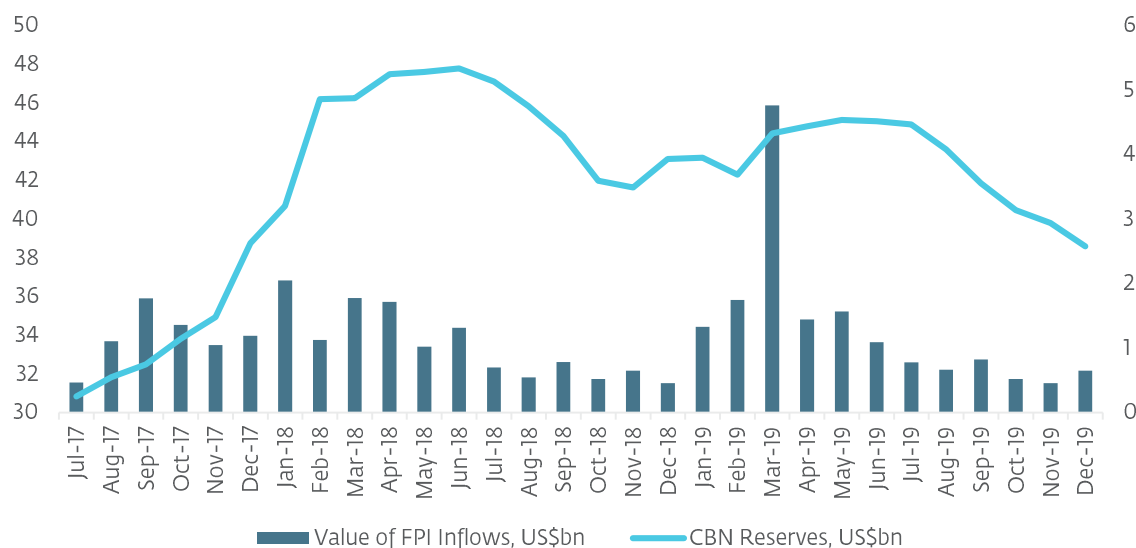
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What do foreign portfolio investors make of the changes?

We believe that foreign portfolio investment (FPI) makes up a significant proportion of the foreign exchange (FX) reserves of the CBN. Foreign investors are able to buy Naira-denominated fixed-income instruments, guarantee the return of their US dollars with certificates of currency importation (CCI), and hedge the value of their Naira/US dollar exposure (though not foreign exchange liquidity) with non-deliverable forwards (NDF).

Given the downward trajectory of the CBN's FX reserves since July 2019 we believe that attracting FPI will be important to the CBN over the coming months. Obviously, since late October foreign investors have preferred buying OMO bills to T-bills. Whether they wish to continue buying OMO bills in part depends on how they consider the lack of fungibility between OMO bills and T-bills and how they assess the falling pool of OMO liquidity overall (now that most domestic institutions cannot purchase them).

Gross inflows of FPI, US\$bn (rhs) and CBN FX reserves, US\$bn (lhs)




Source: CBN, FMDQ, Coronation Research

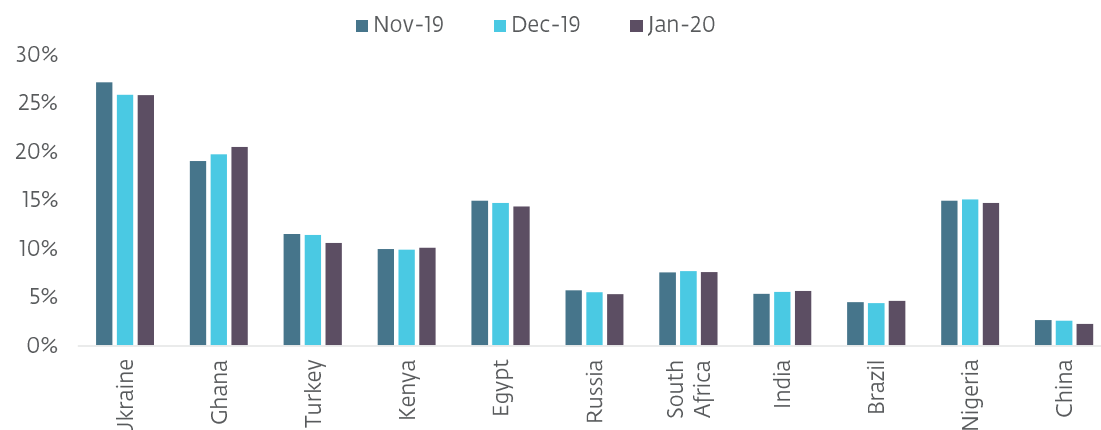
On the face of it, foreign investors are not impressed. Gross FPI appears to have been falling quite rapidly over the past few months. December 2019's gross inflow of FPI, at US\$651m, was definitely on the low side and well below the average for the year (an impression admittedly inflated by the exceptional inflows during March). However, as the chart shows, it would be wrong to deduce too much from a single month's data, especially when it comes close to the end of a year. There is a strong seasonal effect as foreign funds take positions off the table towards year-end.

As the chart at the top of the following page shows, Nigeria's local-currency risk-free fixed income yields – when taking OMO yields in isolation – are attractive in comparison with those of other frontier markets. Therefore there remains a case for FPI, in our view, in purely interest rate terms.

# Foreign investors' reactions (2/2)

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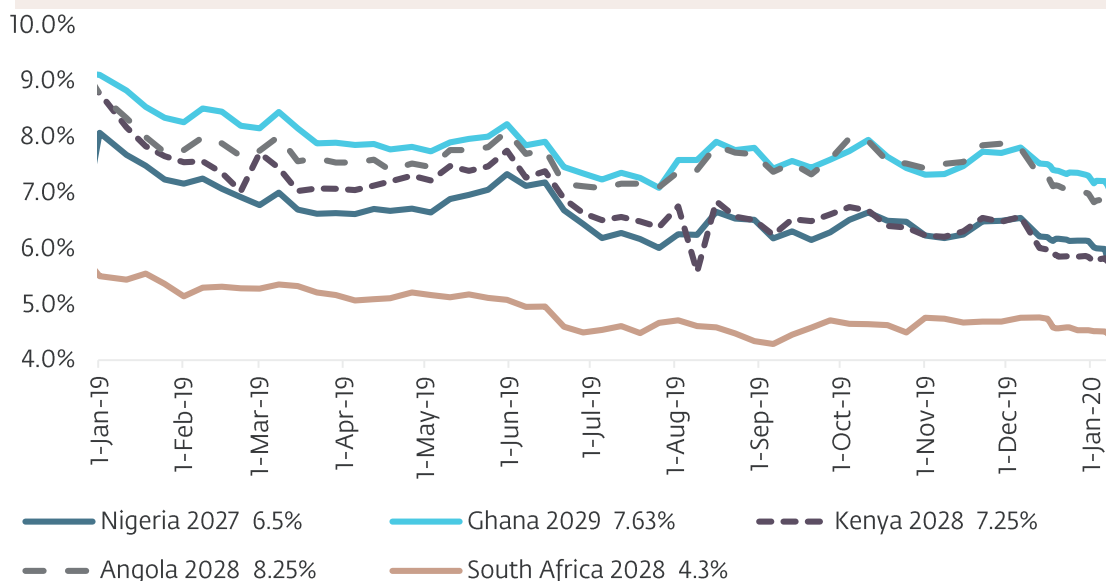
## International emerging and developing market risk-free local currency rates (one year)



Source: FMDQ, Bloomberg, Coronation Research N.B. OMO yields in the case of Nigeria

However, there are many more aspects to the composition of the CBN's reserves than FPI. There are public-sector oil & gas revenues, receipts of foreign currency bonds issued by the FGN, to name but a few. The recent downward trajectory in the CBN's FX reserves may be alleviated if Nigeria accesses external financing in hard currencies.

## Yields on selected African sovereign bonds



Source: Bloomberg, Coronation Research

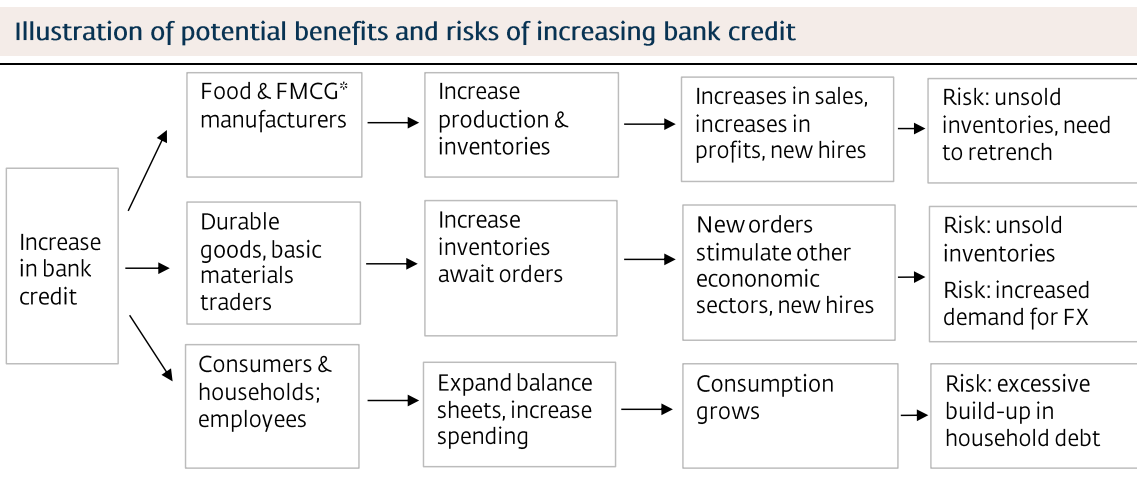
Although Nigeria's B2 rating from Moody's was recently put on negative watch, Nigerian sovereign eurobond yields still tightened. We believe that Nigeria can issue eurobonds during 2020, as well as take significant FX loans (in addition to the N3.0bn World Bank loan announced last year). In addition to these measures, there is the recently-announced US\$29.9bn national funding scheme, some which may be realised during 2020. In other words, we may see stabilisation in the CBN's FX reserves during the first half of 2020, a factor which would support the CBN's current interest rate policy.

# Positive effects on the economy

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## Cheap credit boosts economic activity, though there are risks

Looking at CBN policy from the point of view of economic development, we assess the potential benefits of growing credit, and the risks. The potential benefits amount to increasing economic activity. The risks include: an excessive build-up in inventories; an increase in demand for foreign exchange; and inability on the part of households to respond positively to the stimulus. The latter could lead to a rise in non-performing loans (NPL).



Source: Coronation Research \*Fast-moving consumer goods

## The positives in this policy

On the positive side, there are short-term effects that prepare the ground for accelerated economic growth, which stood at +2.28% in Q3 2019.

Businesses cannot fail to notice that T-bill rates and commercial lending rates are falling below the level of inflation (November: 11.85% y/y). This is an incentive to build inventory. So we expect companies to take risks in building up inventory, and therefore increase production. This applies to the manufacturing sector, which accounts for 8.74% of GDP and which grew by 1.10% year-on-year in Q3 2019.

The same is true of traders, whether trading domestically-produced goods or imported goods. The Trade sector is worth 15.23% of GDP and contracted by 1.45% year-on-year in Q3 2019. We also expect credit to flow to the hitherto under-banked Agriculture (29.26% of GDP in Q3 2019).

The key elements in a sustainable transmission from credit expansion to economic growth are corporate efficiency and consumer confidence, in our view. If both are present then the one-time build up of inventory and production stands to be repeated.

## And the limitations

However, total private sector credit stood at N16.4tn (US\$45.4bn) at the end of September 2019. This is equivalent to just 12.8% of nominal (2018) GDP of N127.7tn. The ability of the bank sector to influence GDP is constrained, in our view, because it lacks scale. Policies such as these work most effectively when credit penetration is high (e.g. 60.0% or more, as is the case in many developed economies).

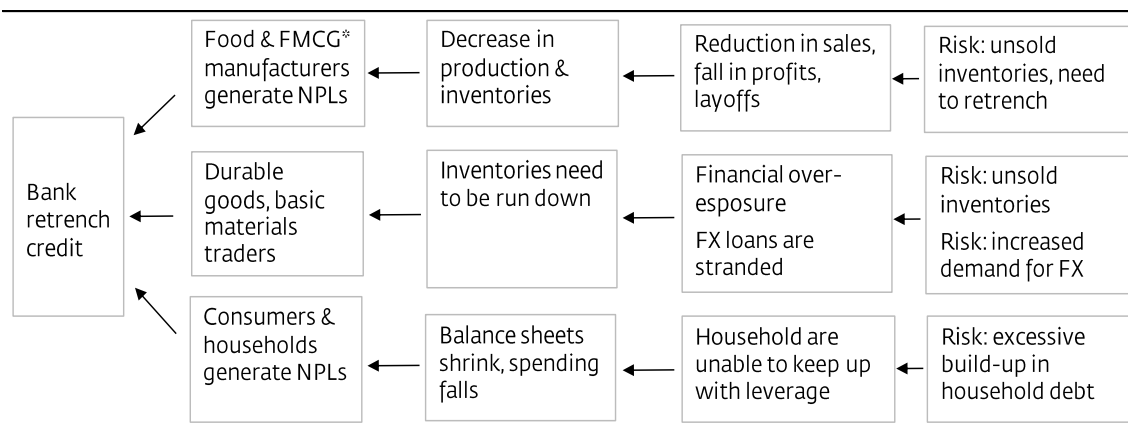
# Risks to the economy

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## How a credit expansion policy can unwind

Any one, or a combination, of the risks we have highlighted could lead to a disruptive unwinding of the financial flows stemming from the CBN's current policy, in our view.

### Illustration of a credit boom going into reverse



Source: Coronation Research \*Fast-moving consumer goods

For example, foreign investors might be deterred from making portfolio investment (FPI) in CBN OMO bills on the grounds that: a) these are no longer fungible with T-Bills; and b) the OMO market is getting smaller. The CBN has addressed this issue by offering to purchase OMO bills from investors wishing to redeem, though it remains to be seen whether this fully replicates the functions of the formerly integrated T-bill and OMO bill market. An extreme – though at this stage remote – outcome could require the re-establishment of fungibility between OMO bills and T-bills, leading to a sharp rise in T-bills rates with knock-on effects on borrowing costs.

Another example of what could go wrong: the build-up in inventory levels may not result in rising sales if consumers lack the confidence to make extra purchases. This could result in un-sold stock, a build up in unsold inventory and ultimately financial distress among manufacturers and traders. This in turn could lead to rising non-performing loans (NPL). Our view of consumer purchasing power is that it remains weak, consistent with the views in our report [Power to the Price Point](#), 20 May 2019.

Although very few consumers can access credit, in our view, there is a danger that consumers make more orders than manufacturers and traders can meet. In this case the likely result would be an uptick in inflation. Inflation has proved to be difficult to bring down from the level of around 11.00% over the past year. Inflation was 11.85% y/y in November 2019.

Most of the above risks are mitigated, in our view, by the small size of outstanding credit to the overall economy, as discussed above.

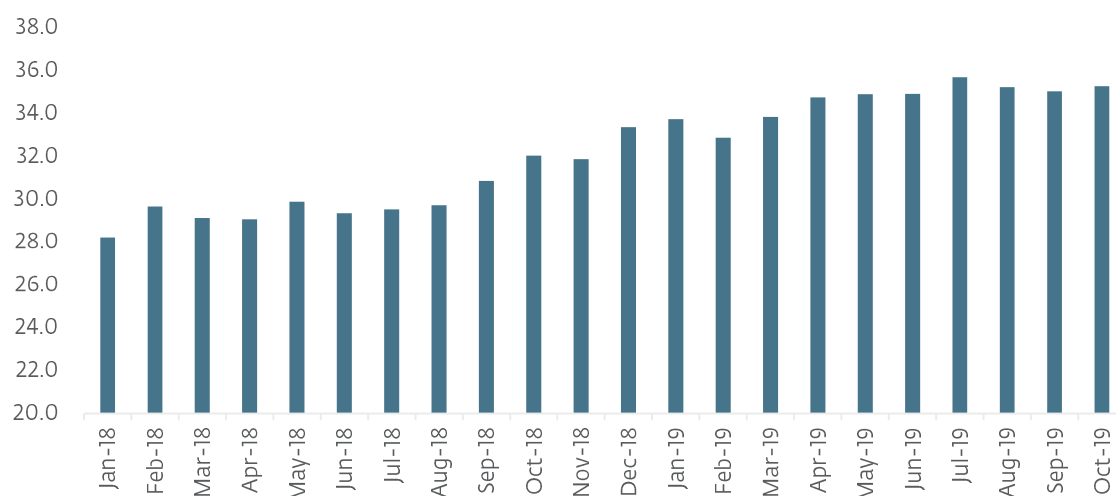
# The economist's template

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## How credit expansion works out in theory

To an economist the CBN's strategy is an attempt to increase money supply (through credit) in order to stimulate the actual stock of goods and production in the economy. The CBN's policies have strongly influenced the growth in private sector credit (as we have seen, private sector credit grew quickly between mid-year and 30 September 2019) but have not, so far, resulted in a rise in money supply overall. This likely reflects the inherently seasonal nature of money supply, which grows towards the traditional festive season at the end of the year – and we only have data up until October 2019. We expect to see a rise in money supply for November and December.

### Money supply\*, Naira trillions



Source: CBN, Coronation Research \*Money supply broad measure (M3), including demand deposits, savings deposits, money market funds, currency outside banks and less liquid long-term deposits

Economists make an equation between money supply, M, multiplied by the velocity of money, V, which equals the price level, P, multiplied by the actual level of goods and production in the economy, Y, or  $MV=PY$ .

A rise in money supply, given a more-or-less constant velocity of money, is likely to result in either a rise in prices, a rise in economic activity, or a combination of the two, e.g. slightly elevated inflation combined with a pick-up in GDP growth. The key elements are a rise in the level of investment, an increase in production and an improvement in consumption.

This seems to be a likely outcome of the CBN's policies in Q4 2019 and on into Q1 2020, in our view, though we point out (again) the small size of the banking sector relative to GDP which weakens transmission from interest rate policy to economic activity.

# Nigerian Banks

## Re-risking is a catalyst

Nigeria's banks spent the second half of 2019 reacting to policy changes aimed at increasing their engagement in the economy. First came the requirement to target loan-to-deposit (LDR) ratios at a minimum 60% by end-September, then 65% by end-December. In October their Nigerian corporate customers were barred from buying new OMO bills from the CBN, an action which sent T-bill rates and loan rates tumbling. The desired effect was achieved, because private sector credit began to grow again (in Q3 2019) after a long period of stagnation.

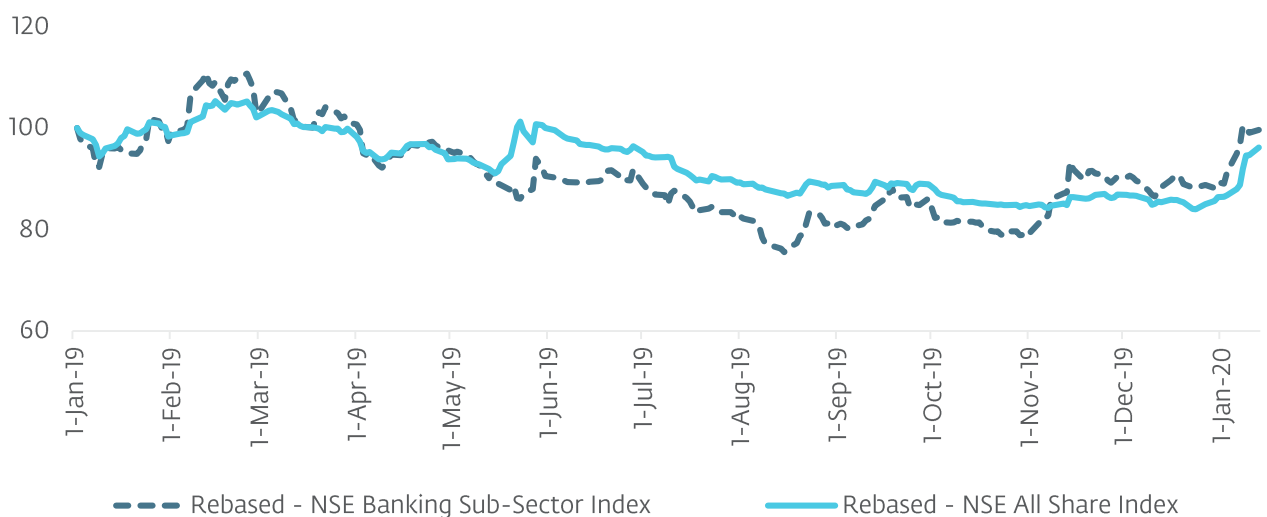
Not all the CBN's changes help banks make money. The recently-announced (on 22 December) reduction in card maintenance and fund transfer fees is a negative development, especially in view of the positive trend in fee & commission income in recent years. Re-pricing deposits when loan rates are falling is difficult. And growing loans rapidly may open the way to increases in non-performing loans (NPL).

However, T-bill rates have fallen so low that several of the banks covered in this section are likely to pay dividends much higher than T-bill yields, in some cases more than twice the T-bill yield. In terms of cost of equity, it is helpful to note that the yield on a 10-year Federal Government of Nigeria (FGN) Naira-denominated bond has fallen from 14.38% three months ago to 11.08% currently. Given cheap valuations, in historical terms, this looks like a reasonable catalyst for stock prices to rise, in our view.

### In this section

- ◆ [Zenith Bank](#)
- ◆ [GT Bank](#)
- ◆ [Access Bank](#)
- ◆ [FBN Holdings](#)
- ◆ [UBA](#)
- ◆ [Stanbic IBTC](#)
- ◆ [Fidelity Bank](#)
- ◆ [Sterling Bank](#)

### NSE all-share index vs NSE banking sub-sector index



Source: Bloomberg, Coronation Research



## Recommendation and price targets

Perhaps it is surprising how long it took, in Q4 2019, for investors to begin buying bank stocks as their response to falling T-bill rates. The rapid gains made by most bank stocks in the first weeks of 2020 put paid to the idea that investors are reluctant to do so. We still think that there is upside potential, and have Buy recommendations on six of our eight covered bank stocks.

	Recommendation	Current Price, Naira/share	New Target Price, N/s	Performance 2019 (%)	Performance y-t-d (%)
Zenith Bank	Buy	21.80	27.50	-19.31	14.79
GT Bank	Buy	31.25	37.50	-13.91	6.40
Access Bank	Buy	10.30	11.25	53.85	5.00
FBNH	Buy	6.50	12.50	-23.12	13.82
UBA	Buy	8.85	11.50	-8.33	15.38
Stanbic IBTC	Buy	42.50	61.35	-14.49	3.65
Fidelity Bank	Hold	2.02	2.50	0.99	2.44
Sterling Bank	Hold	2.00	1.90	4.74	-4.49

	2019e P/BV	2019e RoE	2020f RoE	2020f PE	Potential upside /downside
Zenith Bank	0.76	23%	24%	2.6	26.15%
GT Bank	1.33	32%	31%	4.2	20.00%
Access Bank	0.40	21%	21%	2.4	9.22%
FBNH	0.36	12%	13%	2.2	92.31%
UBA	0.52	20%	22%	2.2	29.94%
Stanbic IBTC	1.33	29%	28%	4.3	44.35%
Fidelity Bank	0.28	15%	16%	1.5	23.7%
Sterling Bank	0.55	11%	12%	4.5	-5.00%

Source: Bloomberg, Coronation Research. Priced at 08 January, 2020

Yet, for the most part, we have been cautious about forecasting significant earnings gains for the banks in 2020f. Although the regulatory environment presents them with significant opportunities, there are risks and it is not certain that earnings from inflated loan books will make up for pressure on margins. The banks themselves are – most of them – cautious in their guidance for 2020 earnings forecasts. Q4 2019 and Q1 2020 will be important to watch for inflection in earnings.

Another factor which argues for a degree of caution is the fact that loan growth requires capital. For most of the banks covered here capital does not prevent an obstacle, but for a few it does. The CBN did state, in 2019, that it wants to see banks raise more capital, and this could translate into policy later this year. This factor alone, in our view, is not a sufficiently strong reason to avoid buying bank stocks: the combination of low valuations, high dividend yields and low yields on T-bills persuades us that the investment case is strong.

# Zenith Bank

Zenith Bank (Zenith) is one of our preferred banks due to its consistent performance over the last five years and its above-average long-term RoAE of 21.0%. The bank maintains strong capital, liquidity, asset quality and profitability ratios. We expect the bank to continue to deliver strong profitability in the near to medium term.

## Profitability

Zenith's consistent long-term RoAE has come from strong sustainable income lines – interest income & fee income. The fee and commission income trends have been upwards, driven by e-banking fees as the volume of online transactions have been on the rise during the last five years.

Non-interest income accounted for 42.2% of total operating income in 9M 2019, bolstered by trading and derivative income. Although management assures investors that derivatives and trading income levels will be maintained, we are a little uncertain about their sustainability in the near to medium term given a possible decline in the volume of transactions due to the CBN's OMO policy which has reduced the number of participants in the OMO market.

## Loan Book

Zenith's asset quality has remained strong through the years, the non-performing loan (NPL) ratio has remained sub 5.0% over the last five years and the cost of risk (COR) of 1.0% annualised for 9M 2019 gives us confidence that the impact of impairment charges on the bottom line will be low at FY 2019e.

Strong asset quality and low impairment charges have resulted in increased retained earnings and a build-up of the bank's capital base (capital adequacy ratio of 23.8% at 9M 2019). Given the regulatory minimum loan-to-deposit ratio of 65.0%, effective 31 December 2019, the bank is in a comfortable position to grow its loan book without raising additional capital, in our view.

Rating	Buy
Price (N)	21.80
Price target (N)	27.50
Up/downside potential	26.15%
Market cap (Nbn/US\$m)	723 / 1,988
Bloomberg	ZENITH:NL
Reuters	ZENITHB.LG
Free float	90.45%

Priced at 08 January 2020

Share price performance (N)



Source: Bloomberg, Coronation Research

N millions	2019e	2020f	2021f
Net Interest Income	286,285	314,411	338,373
change	-3%	10%	8%
Net F&C Income	100,702	113,282	127,914
change	23%	12%	13%
Operating Expenses	(237,257)	(250,407)	(264,128)
change	3%	6%	5%
Provisions	(25,529)	(34,414)	(36,135)
Pre-Tax Profits	232,999	262,550	297,670
Profits After Tax	200,379	228,418	258,973
change	4%	14%	13%
RoE	23%	24%	25%
P/BV	0.76	0.68	0.62
PE	3.0	2.6	2.3

Source: Company, Coronation Research estimates, Operating Expenses = Personnel Expenses + Administrative Expenses + Depreciation (where this is broken out) + (other direct expenses where applicable). Priced at 08 January, 2020.

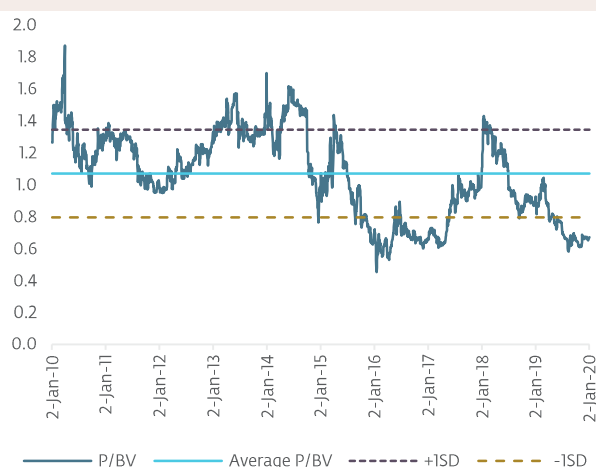
# Zenith Bank

## Valuation

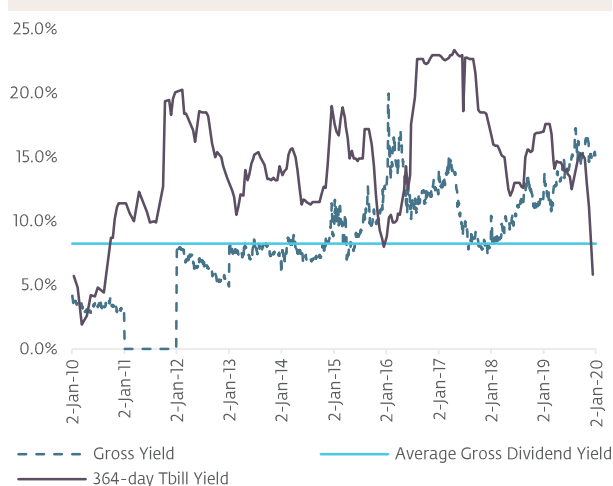
Our recommendation points to the historically low valuations of Zenith Bank's stock coupled with its gross dividend yield that is currently higher than the 364-day T-bill available to local investors.

Zenith currently has a gross dividend yield of 13.8% in prospect when compared with the yield on a 364-day T-bill, currently at 5.8%. It is reasonable for investors and portfolio managers to position themselves for the FY 2019e dividend.

Historic P/BV



Gross Dividend Yield



Source: Bloomberg for prices, Coronation Research.

Over the last nine years, investors have valued Zenith at an average of 1.1x historic P/BV. But it currently trades 40.0% below this level, and we think the average level could be reached in a year, given its strong and consistent earnings trend. To trade at the nine-year average historic P/BV of 1.1x, Zenith Bank stock would reach a price of N30.5/s. We think that Zenith Bank can reach 90.0% of this price in a year, and maintain our price target of N27.5/s.

# Zenith Bank: forecasts

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Income statement Nm	2014	2015	2016	2017	2018	2019e	2020f	2021f
Net Interest Income	206,503	224,582	240,179	257,991	295,594	286,285	314,411	338,373
Net Fee and Commission Income	70,512	60,904	68,444	90,143	81,814	100,702	113,282	127,914
Other Income	19,547	23,680	54,996	180,418	98,149	108,798	119,678	131,646
Operating Income	296,562	309,166	363,619	528,552	475,557	495,785	547,371	597,934
Loan loss & other provision	(13,064)	(15,673)	(32,350)	(98,227)	(18,372)	(25,529)	(34,414)	(36,135)
Operating expenses	(163,702)	(167,877)	(174,521)	(226,864)	(229,552)	(237,257)	(250,407)	(264,128)
Pretax profits	119,796	125,616	156,748	203,461	227,633	232,999	262,550	297,670
Effective tax rate	17%	16%	17%	10%	15%	14%	13%	13%
Net Profits	99,455	105,663	129,652	182,283	193,424	200,379	228,418	258,973
EPS (reported)	3.16	3.36	4.36	5.36	6.36	7.36	8.36	9.36
DPS	1.75	1.80	2.02	2.70	2.80	3.00	3.00	3.00
Payout ratio	55%	53%	49%	47%	76%	57%	57%	57%
Dividend sum	54,854	56,513	63,420	84,769	147,561	113,889	129,871	147,287
Weighted Ave. Share Count	31,396	31,396	31,396	31,396	31,396	31,396	31,396	31,396
<b>Statement of financial position</b>								
Cash and balances with CBN	752,580	761,561	669,058	957,663	954,416	861,117	904,172	1,062,959
Loans and advances to Bank	506,568	272,194	459,457	495,803	674,274	699,559	725,793	753,010
Loans and advances to Customers	1,729,507	1,989,313	2,289,365	2,100,362	1,823,111	2,022,338	2,244,493	2,356,717
change	38%	15%	15%	-8%	-13%	11%	11%	5%
Investment securities	200,079	213,141	199,478	330,951	565,312	587,924	611,441	635,899
Fixed assets (PP&E)	71,571	87,022	105,284	133,384	149,137	152,247	133,356	112,466
Other assets	494,959	683,611	1,017,183	1,577,090	1,789,460	1,842,766	1,898,709	1,857,631
Total assets	3,755,264	4,006,842	4,739,825	5,595,253	5,955,710	6,165,950	6,517,964	6,778,682
Customer deposits	2,537,311	2,557,884	2,983,621	3,437,915	3,690,295	3,745,649	3,801,834	3,858,862
Other liabilities	665,315	854,605	1,051,739	1,335,680	1,449,664	1,518,515	1,716,240	1,810,262
Total liabilities	3,202,626	3,412,489	4,035,360	4,773,595	5,139,959	5,264,164	5,518,074	5,669,123
Shareholders' Funds	552,086	593,760	703,482	820,341	814,213	900,129	998,102	1,109,213
Minority Interest	552	593	983	1,317	1,538	1,657	1,788	346
BVPS	17.6	18.9	22.4	26.2	26	28.7	31.8	35.3
<b>Ratios</b>								
Cost/income ratio ex prov.	55.2%	54.3%	48.0%	42.9%	48.3%	47.9%	45.7%	44.2%
Cost/income ratio	57.7%	57.2%	52.7%	52.7%	50.2%	50.5%	48.8%	47.0%
Pre-tax margin	29.7%	29.0%	30.9%	27.3%	36.1%	36.5%	37.8%	39.8%
RoAA	2.9%	2.7%	3.0%	3.5%	3.3%	3.3%	3.6%	3.9%
RoAE	18.8%	18.4%	20.0%	23.9%	23.7%	23.4%	24.1%	24.6%
NPL ratio	1.8%	2.2%	3.0%	4.1%	5.0%	4.9%	4.9%	4.9%
Cost of risk	0.9%	0.8%	1.5%	0.8%	0.9%	1.2%	1.5%	1.5%
Leverage	6.8x	6.7x	6.7x	6.8x	7.3x	6.9x	6.5x	6.1x
Loan to deposit	68%	78%	77%	61%	49%	54%	59%	61%
Capital adequacy ratio (CAR)	20%	21%	22%	24%	25%	25%	25%	25%
Price to book ratio	1.70	0.74	0.66	0.98	0.89	0.76	0.68	0.62
Price to earnings ratio	8.62	4.02	3.29	4.10	3.75	3.0	2.6	2.3
Dividend yield	6.4%	12.8%	13.7%	10.5%	12.1%	13.8%	13.8%	13.8%

Source: Company, Coronation Research

# Guaranty Trust Bank

Our key investment thesis for Guaranty Trust Bank (GT Bank) is that, over the years, it has maintained greater earnings consistency than its peer group banks. Its above-peer-group return on equity, largely as a result of its low cost-to-income ratio, makes the case for the premium pricing of its stock, in our view. We believe the bank will continue to outperform peers in 2019e and 2020f.

## Profit development

We are confident in management's ability to deliver earnings growth in 2019e and 2020f, although we believe that Net Profit growth is likely to be high single-digit or low double-digit, compared with growth rates of 20% in the past. With a total capital adequacy ratio (CAR) of 23.6% at 9M 2019, the bank is adequately capitalised to grow risk assets to meet the regulatory minimum loan-to-deposit ratio of 65.0%, in our view.

We forecast non-interest income growing out to 2021f as the bank continues customer penetration with its mobile banking strategy. The value of transactions in mobile banking grew 62% y/y in 9M 2019, according to management. The bank has the most used mobile banking platform, in our view, and arguably the most recognised. We see value in this in the medium term.

GT Bank has long had among the lowest cost-to-income ratios and best shareholder returns among Nigerian banks. It can be argued that the 31.8% RoE we expect it to report for 2019e is the highest in the Nigerian banking industry. We forecast operating expenses to continue to grow at a single-digit percentage rate, sub-inflation, in 2019e and 2020f.

## Asset Quality

GT Bank did not grow risk assets in aggregate between 2016-2018, but we may see a change in this trend in 2019e and 2020f. In order to comply with the minimum loan-to-deposit ratio, GT Bank will have to grow its loan book by approximately N220bn (+13.8%) above the 9M 2019 number, or reduce its deposits. If it chooses the former we may see an increase in cost of risk (CoR) and impairment provisions in 2020f.

Rating	Buy
Price (N)	31.25
Price target (N)	37.50
Up/downside potential	20.0%
Market cap (Nbn/US\$m)	1015 / 2789
Bloomberg	GUARANTY:NL
Reuters	GUARANTLLG
Free float	99.8%

Priced at 08 January 2020

Share price performance (N)



Source: Bloomberg, Coronation Research

N millions	2019e	2020f	2021e
Net Interest Income	230,683	246,935	261,792
change	4%	7%	6%
Net F&C Income	61,179	72,667	86,928
change	21%	19%	20%
Operating Expenses	(132,136)	(138,163)	(144,728)
change	4%	5%	5%
Provisions	(4,689)	(5,507)	(5,935)
Pre-Tax Profits	228,189	254,954	283,686
Profits After Tax	196,243	211,612	235,459
change	6%	8%	11%
RoE	32%	31%	32%
P/BV	1.3	1.2	1.2
PE	4.5	4.2	3.7

Source: Company, Coronation Research estimates, Operating Expenses = Personnel Expenses + Administrative Expenses + Depreciation (where this is broken out) + (other direct expenses where applicable). Priced at 08 January, 2020.

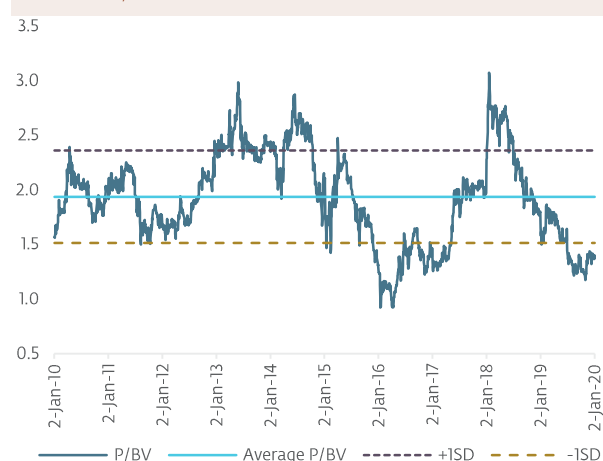
# Guaranty Trust Bank

## Valuation

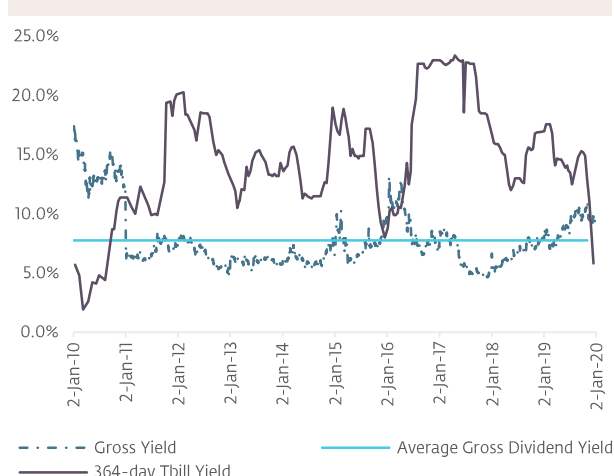
GT Bank has a gross dividend yield of 9.6%, significantly higher than the current 364-day T-bill yield at 5.8%. We think the gross dividend yield could increase to 10.5% at FY 2019e and 10.8% in 2020f. It makes sense, in our view, for investors to position themselves for a potential N3.0/s dividend on 2019e earnings and possible appreciation in GT Bank's share price.

Over time GT Bank's shares have traded at an average P/BV of 1.9x. They are now trading at 29.5% below this level.

### Historic P/BV



### Gross Dividend Yield



Source: Bloomberg for prices, Coronation Research.

We have a target price of N37.5/s for GT Bank and given the upside compared to the current price of N29.2/s, we place a Buy rating on the stock. Our target price is based on an implied price to book ratio of 1.60x to our 2019e BVPS of N23.9.

# GT Bank: forecasts

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Income statement Nm	2014	2015	2016	2017	2018	2019e	2020f	2021f
Net Interest Income	142,392	159,947	195,400	246,663	222,434	230,683	246,935	261,792
Net Fee and Commission Income	45,856	48,786	35,947	40,732	50,470	61,179	72,667	86,928
Other Income	29,674	20,748	112,718	48,274	74,718	73,152	79,022	85,628
Total operating income	217,922	229,481	344,065	335,670	347,622	365,014	398,624	434,348
Loan loss & other provision	(7,098)	(12,408)	(65,290)	(12,169)	(4,906)	(4,689)	(5,507)	(5,935)
Operating expenses	(94,438)	(96,378)	(113,639)	(123,258)	(127,128)	(132,136)	(138,163)	(144,728)
Pretax profits	116,386	120,695	165,136	200,242	215,587	228,189	254,954	283,686
Effective tax rate	15%	18%	20%	15%	14%	14%	17%	17%
Net Profits	98,695	99,437	132,281	170,470	184,640	196,243	211,612	235,459
Minority Interest	(698)	-	-	-	-	-	-	-
Net Profits attributable to shareholders	97,997	99,437	132,281	170,470	184,640	196,243	211,612	235,459
EPS (reported)	3.33	3.38	4.49	5.79	6.57	6.98	7.53	8.38
DPS	1.75	1.77	2.00	2.30	2.70	3.00	3.20	3.50
Payout ratio	52%	52%	44%	40%	43%	45%	49%	50%
Dividend sum	51,504	52,093	58,862	67,691	79,464	88,293	103,009	117,724
Weighted Ave. Share Count	29,431	29,431	29,431	29,431	28,111	28,111	28,111	28,111
<b>Statement of financial position</b>								
Cash and cash equivalents	246,940	254,633	455,863	641,974	676,989	908,145	994,123	1,022,144
Loans and advances to banks	5,696	1,052	654	750	2,995	3,045	3,095	3,145
Loans and advances to Customers	1,275,681	1,371,926	1,589,430	1,448,533	1,259,010	1,713,794	1,885,174	2,031,799
Investment securities	379,863	393,588	528,213	613,959	637,325	732,923	842,862	969,291
Other assets	447,697	503,395	542,234	645,880	711,024	771,434	831,857	892,294
Total assets	2,355,877	2,524,594	3,116,393	3,351,097	3,287,343	4,129,341	4,557,111	4,918,673
Customer deposits	1,618,208	1,610,350	1,986,246	2,062,048	2,273,903	2,433,076	2,603,392	2,785,629
Deposits from banks	31,662	26,257	125,068	85,431	82,803	91,083	100,192	110,211
Debt securities issued	167,321	180,117	126,238	92,132	0	0	0	0
other borrowed funds	91,299	165,123	219,634	220,492	178,567	669,336	803,250	848,994
Other liabilities	73,054	129,185	154,305	265,827	176,502	250,329	324,156	397,983
Total liabilities	1,981,544	2,111,032	2,611,491	2,725,929	2,711,775	3,443,825	3,830,990	4,142,817
Shareholders' Funds	368,653	407,173	496,060	613,685	563,134	671,083	709,687	757,422
Minority Interest	5,679	6,389	8,843	11,483	12,433	14,433	16,433	18,433
Total shareholders funds	374,333	413,562	504,903	625,168	575,567	685,517	726,120	775,856
BVPS	12.5	13.8	16.9	20.9	20.0	23.9	25.2	26.9
<b>Ratios</b>								
Cost/income ratio ex provisions	43.3%	42.0%	33.0%	36.7%	36.6%	36.2%	34.7%	33.3%
Cost/income ratio	44.8%	44.4%	40.8%	38.1%	37.1%	36.7%	35.1%	33.8%
Pre-tax margin	42.1%	40.4%	40.2%	48.1%	49.9%	50.8%	52.5%	53.9%
RoAA	4.4%	4.1%	4.7%	5.3%	5.6%	5.3%	4.9%	5.0%
RoAE	28.4%	25.6%	29.3%	30.2%	31.4%	31.8%	30.7%	32.1%
NPLratio	3.0%	3.6%	3.8%	7.7%	5.0%	4.5%	4.5%	4.5%
Cost of risk	0.6%	0.9%	4.3%	0.8%	0.2%	0.3%	0.3%	0.3%
Leverage	6.3x	6.1x	6.2x	5.4x	5.7x	6.0x	6.3x	6.3x
Loan to deposit	79%	85%	80%	70%	55%	65%	72%	73%
Capital adequacy ratio (CAR)	21%	18%	20%	26%	23%	25%	24%	24%
Price to book ratio (x)	3.57	3.23	2.65	2.14	1.72	1.3	1.2	1.2
Price to earnings ratio	12.58	12.60	9.05	7.11	5.48	4.5	4.2	3.7
Dividend yield	3.9%	4.0%	4.5%	5.1%	7.8%	9.6%	10.2%	11.2%

# Access Bank

Access Bank (Access) could win awards for consistency in Nigerian banking. It made consistent gains in Net Profits from 2013 to 2018, during which time it built up shareholders' funds from N242.3bn to N614.8bn (US\$1.8bn) at 9M 2019.

## M&A the recipe for success

Access appears to have mastered the art of turning around the fortunes of banks in difficulties and extracting value from them. Notable was the takeover of Intercontinental bank in 2013 followed by the merger with Diamond Bank in 2019 and most recently the acquisition of a 97.0% stake in Transnational Bank of Kenya, a deal still subject to approval from the Kenyan regulator.

In our view, the merger of Access with Diamond Bank positions the combined entity for future growth and increased profitability in 2020f, given a combination of retail and corporate banking expertise.

Through its acquisition of a majority stake in Transnational Bank of Kenya, Access joins other Nigerian lenders such as GT Bank and UBA in operating in the Kenyan market.

Transnational Bank of Kenya, just like Diamond Bank in 2018, is grappling with non-performing loans (NPL ratio of 58.8%). It is unprofitable posting a loss of KSh98.5 million (US\$0.98m), in FY 2018. The management of Access stated that the reason for this is due to the loss of its correspondent trade lines which, post-takeover, it can now replace with the aim of transforming the bank into a profitable one.

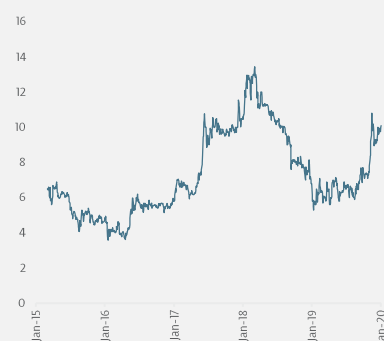
## Asset quality

Access's asset quality deteriorated upon its merger with Diamond Bank. The NPL ratio increased from 2.5% in FY 2018 to 6.4% in 9M 2019. If its recent acquisition in Kenya goes ahead then we think there may be a further slight decline in asset quality in aggregate in 2020f. Therefore, we do not see any substantial reduction in impairment provisions in 2020f.

Rating	Buy
Price (N)	10.10
Price target (N)	11.25
Up/downside potential	11.4%
Market cap (Nbn/US\$m)	368 / 1,082
Bloomberg	ACCESS:NL
Reuters	ACCESS.LG
Free float	83.3%

Priced at 08 January 2020

Share price performance (N)



Source: Bloomberg, Coronation Research

N millions	2019f	2020f	2020f
Net Interest Income	279,422	353,945	430,870
change	61%	27%	22%
Net F&C Income	74,054	85,461	99,461
change	41%	15%	16%
Operating Expenses	(258,801)	(296,846)	(330,816)
change	33%	15%	11%
Provisions	(14,364)	(14,140)	(15,413)
Pre-Tax Profits	133,997	175,021	240,747
Profits After Tax	118,587	138,267	190,190
change	25%	17%	38%
RoE	21%	21%	24%
P/BV	0.4	0.5	0.4
PE	2.8	2.4	1.7

Source: Company, Coronation Research estimates, Operating Expenses = Personnel Expenses + Administrative Expenses + Depreciation (where this is broken out) + (other direct expenses where applicable), Priced at 08 January, 2020.



# Access Bank

## Costs still a pressure point

Operating costs at Access have long been an issue, with the cost-to-income ratio stubbornly above 65.0% for several years. The ratio is higher than the industry average of c.54.0%. If Access can put a lid (annual growth rate in operating expenses at 5.0%) on its operating expenses we would see its return on average equity rise to 23.4% and its return on average assets rise to 2.3% in 2020f.

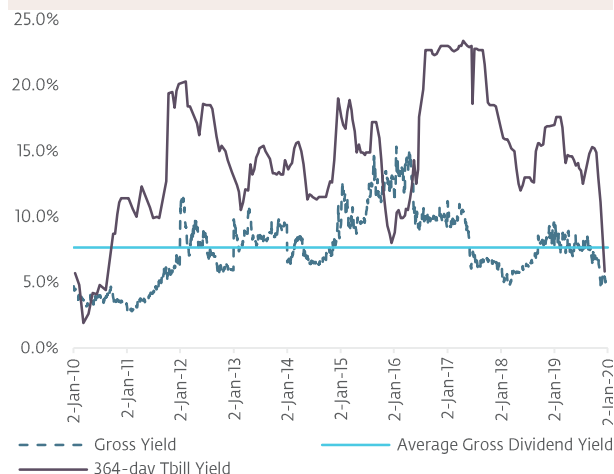
## Capital adequacy

Overall, we view Access's strong capital position (a total capital adequacy ratio of 24.0% at 9M 2019) and large loan book as positive. We believe Access can, to some extent, maintain growth in its loan book to deliver strong top and bottom line numbers.

Historic P/BV



Gross Dividend Yield



Source: Bloomberg for prices, Coronation Research.

## Valuation

Access trades at 64.0% of its average P/BV over the past nine years. To trade at its average P/BV over this period the stock would have to reach N11.25/s.

Access currently has a gross dividend yield of 5.0%, with a potential to reach 8.7% at FY 2019e, when compared with the yield on a 364-day T-bill, currently at 5.8%. It is reasonable for investors and portfolio managers to position themselves for the FY 2019e dividend and a potential rally in the stock price. Therefore, we set a target price of N11.50/s and a Buy recommendation.

# Access Bank: forecasts

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Income statement Nm	2014	2015	2016	2017	2018	2019e	2020f	2021f
Net Interest Income	100,017	105,382	139,148	163,452	173,578	279,422	353,945	430,870
Net Fee and Commission Income	30,760	33,313	54,864	56,597	52,495	74,054	85,461	99,461
Other non-interest Income	37,503	96,138	78,594	82,547	85,734	53,687	46,601	56,645
Operating income	168,280	234,832	272,605	302,596	311,807	407,162	486,008	586,976
Loan loss & other provision	(11,652)	(14,225)	(21,953)	(34,467)	(14,657)	(14,364)	(14,140)	(15,413)
Operating expenses	(104,605)	(145,569)	(160,313)	(188,057)	(193,962)	(258,801)	(296,846)	(330,816)
Pretax profits	52,023	75,038	90,339	80,072	103,188	133,997	175,021	240,747
Effective tax rate	17%	12%	21%	23%	8%	12%	21%	21%
Net Profits	43,064	65,869	71,439	61,991	94,981	118,587	138,267	190,190
EPS (reported)	1.88	2.65	2.47	2.14	3.28	3.62	4.23	5.81
DPS	0.60	0.55	0.65	0.65	0.65	0.85	1.00	0.65
Payout ratio	32%	21%	22%	26%	20%	23%	24%	11%
Dividend sum	13,730	13,561	16,028	16,028	18,804	27,807	32,715	21,265
Shares outstanding	22,883	24,657	24,658	28,928	28,929	32,715	32,715	32,716

## Statement of financial position

Cash and balances with CBN	405,015	478,409	713,889	953,944	740,926	1,224,134	1,625,424	1,462,819
Loans and advances to Bank	12,436	42,734	45,203	68,114	142,490	163,863	188,442	216,709
Loans and advances to Customers	1,110,464	1,365,831	1,809,459	1,995,988	1,993,606	2,652,176	2,858,424	3,115,682
Investment securities	270,211	186,223	229,114	278,168	501,072	531,137	547,071	563,483
Fixed assets (PP&E)	69,660	73,330	84,109	97,115	103,669	110,406	113,994	114,432
Other assets	236,575	444,803	602,091	708,915	1,472,394	1,794,561	2,022,404	2,293,576
Total assets	2,104,361	2,591,330	3,483,866	4,102,243	4,954,157	6,476,278	7,355,759	7,766,700
Customer deposits	1,454,419	1,683,244	2,089,197	2,244,879	2,564,908	2,847,048	3,017,871	3,198,943
Other liabilities	145,993	150,916	314,448	711,939	1,248,554	1,474,845	1,661,353	1,899,579
Taxation	8,181	7,781	5,939	7,490	4,058	3,859	3,660	3,461
Deferred taxation	59	267	3,699	8,764	6,457	6,467	6,477	6,487
Long term liabilities/borrowings	218,297	381,321	616,088	613,724	639,668	1,525,019	1,950,347	1,808,809
Total liabilities	1,826,950	2,223,529	3,029,371	3,586,795	4,463,645	5,857,238	6,639,708	6,917,279
Shareholders' Funds	273,880	363,902	448,248	508,540	482,641	610,954	707,741	840,874
Minority Interest	3,531	3,900	6,247	6,908	7,870	8,085	8,310	8,547
BVPS	12.1	14.9	15.7	17.8	17.0	18.9	21.9	26.0

## Ratios

Cost/income ratio	69.1%	68.0%	66.9%	73.5%	66.9%	67.1%	64.0%	59.0%
Cost/income ratio ex prov.	62.2%	62.0%	58.8%	62.1%	62.2%	63.6%	61.1%	56.4%
Pre-tax margin	21.2%	22.2%	23.7%	17.4%	19.5%	19.9%	23.1%	27.7%
RoAA	2.6%	3.2%	2.4%	1.6%	2.1%	2.1%	2.0%	2.5%
RoAE	16.5%	20.4%	17.4%	12.8%	18.9%	21.4%	20.7%	24.3%
NPL ratio	1.7%	1.7%	1.9%	2.0%	2.7%	4.4%	4.4%	4.4%
Cost of risk	1.2%	1.0%	1.3%	1.3%	0.7%	0.6%	0.5%	0.5%
Leverage ratio	7.6x	7.0x	7.7x	8.0x	10.1x	10.5x	10.3x	9.1x
Loan to deposit	71%	80%	82%	77%	60%	68%	67%	66%
Capital adequacy ratio (CAR)	18%	20%	20%	18%	21%	24%	24%	24%

Price to book ratio (x)	0.93	0.75	0.72	0.63	0.62	0.36	0.46	0.39
Price to earnings ratio	5.62	3.70	4.12	4.94	3.26	2.79	2.39	1.74
Dividend yield	5.3%	4.9%	5.8%	5.8%	9.6%	8.7%	10.2%	6.6%

Source: Company, Coronation Research

# FBN Holdings

We believe that FBN Holdings (FBNH) can boost returns now that it has kept a lid on its impairment provisions. Favourable conditions (improved asset quality over the last two years; FX stability and improvement in the economy) give us comfort about its ability to manage its balance sheet to generate top-line income and deliver bottom-line profits.

## Asset Quality

FBNH has grappled with non-performing loans (NPL) and has taken significant impairment charges over the last five years. These amount to c.N530bn (US\$1.5bn) which compares with an equity base of some N605bn (US\$1.7bn) as at 9M 2019, and a loan book of N1,819bn (US\$5.1bn), gross, as 9M 2019. Most of these impairments were for exposures to the oil & gas sector.

This phase appears to be tapering off as the bank has succeeded in reducing its NPL ratio from 25.8% at FY 2018 to 14.5% at 9M 2019. However, the NPL ratio is still much higher than its peer group among the largest listed banks (simple average 7.5%). However, we think that the reduction is likely to boost the bottom line which in turn is likely to increase shareholders return from 10.1% in FY 2018 to 12.8% in FY 2019e and 16.1% in 2020f.

## Net Interest Margin and Fee & Commission Income

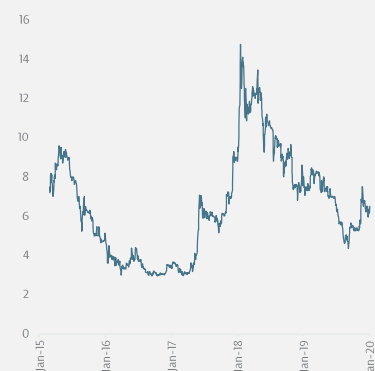
We expect a slight increase in NIMs due to the minimum 65.0% regulatory loan-to-deposit ratio - which requires banks to increase lending to stimulate the economy - in 2019e and 2020f. We believe the bank is going to be more cautious than before in growing its risk assets given its tight capital adequacy ratio (total capital adequacy stood at 17.0% at 9M 2019 when the minimum capital adequacy ratio for a strategically important bank is 16.0%).

Growth in fee and commission income has been strong over the last three years, averaging 13.5% during this period. The growth is largely due to increasing take-up and robustness of the bank's electronic banking franchise and increase in credit-related fees.

Rating	BUY
Price (N)	6.50
Price target (N)	12.50
Up/downside potential	92.3%
Market cap (Nbn/US\$m)	287 / 787
Bloomberg	FBNH:NL
Reuters	FBNH.LG
Free float	97.6%

Priced at 02 January 2020

### Share price performance (N)



Source: Bloomberg, Coronation Research

N millions	2019e	2020f	2021f
Net Interest Income	281,565	338,106	367,635
change	-1%	20%	9%
Net F&C Income	87,238	100,968	116,911
change	16%	16%	16%
Operating Expenses	(292,858)	(317,414)	(343,885)
change	11%	8%	8%
Provisions	(40,103)	(54,877)	(63,921)
Pre-Tax Profits	79,132	114,465	129,312
Profits After Tax	69,637	97,295	109,915
change	17%	40%	13%
RoE	10%	13%	16%
P/BV	0.4	0.3	0.3
PE	3.0	2.2	1.9

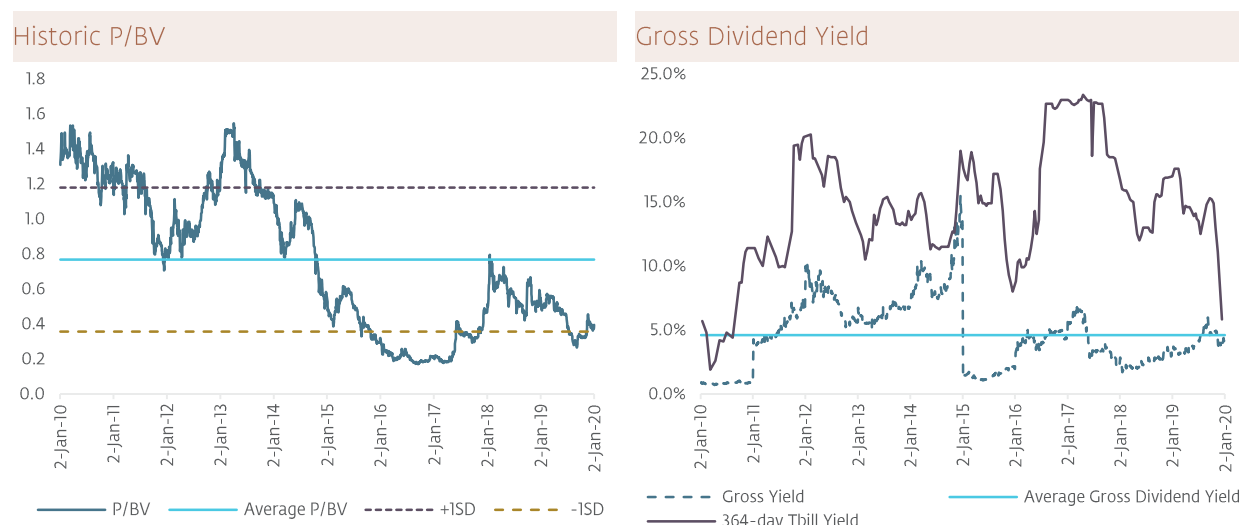
Source: Company, Coronation Research estimates, Operating Expenses = Personnel Expenses + Administrative Expenses + Depreciation (where this is broken out) + (other direct expenses where applicable). Priced at 8 January, 2020.

# FBN Holdings

## Valuation

The attractions of FBNH as an investment are obvious: a deposit base of N3.7tn (U\$10.3bn), the 3rd largest base in the sector; customer loans at N1.8tn; investment securities at N1.5tn; and a net interest margin (reported for 9M 2019) of 7.3%. Management is tackling its cost/income ratio (9M 2019: 71.5%).

Our Buy recommendation points to the historically low valuations of FBNH stock. Our valuation history of FBNH shows that the stock currently trades at 0.36x Price-to-Book Value (P/BV) and 50.1% below its 9-year historic P/BV. Given the differential between the 9-year average and current P/BV we think the stock looks attractive.



Source: Bloomberg for prices, Coronation Research. Priced at 02 January, 2020.

Turning to the stock’s yield, FBNH currently has a gross dividend yield of 5.4%, slightly lower than the current 364-day T-bill yield at 5.8%. We think the gross dividend yield could increase to 8.50% at FY 2019e and 11.8% in 2020f.

To trade at the nine-year average historic P/BV of 0.77x, FBNH stock would reach a price of N12.6/s. We think that FBNH can reach this level in a year, and we maintain our price target of N12.5/s.

# FBN Holdings: forecasts

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Income statement Nm	2014	2015	2016	2017	2018	2019e	2020f	2021f
Net Interest Income	243,854	265,165	304,442	331,522	284,168	281,565	338,106	367,635
Net Fee and Commission Income	60,778	54,277	60,287	62,336	75,394	87,238	100,968	116,911
Other Income	48,908	36,327	96,758	40,743	56,320	43,290	47,682	52,572
Operating Income	353,540	355,769	461,487	434,601	415,882	412,093	486,756	537,118
Loan loss & other provision	(25,942)	(118,794)	(226,037)	(150,424)	(86,911)	(40,103)	(54,877)	(63,921)
Operating expenses	(236,845)	(222,735)	(220,933)	(238,016)	(263,706)	(292,858)	(317,414)	(343,885)
Pretax profits	93,457	21,581	22,948	56,395	65,265	79,132	114,465	129,312
Effective tax rate	11%	28%	25%	16%	8%	12%	15%	15%
Net Profits	84,011	15,539	17,141	47,785	59,744	69,637	97,295	109,915
EPS	2.57	0.48	0.38	1.47	1.84	2.14	3.00	3.38
DPS	0.10	0.15	0.20	0.37	0.51	0.59	0.82	0.93
Payout ratio	4%	32%	0%	25%	28%	28%	28%	28%
Weighted Ave. Share Count	32,630	32,630	32,630	32,473	32,473	32,473	32,473	32,473
<b>Statement of financial position</b>								
Cash and balances with CBN	698,104	715,871	690,165	641,881	653,335	749,997	757,497	768,589
Loans and advances to Bank	460,911	385,769	444,871	742,929	863,435	949,779	1,044,756	1,149,232
Loans to Customers	2,178,986	1,817,271	2,083,894	2,001,223	1,683,813	1,915,331	2,003,135	2,083,260
change	23%	-17%	15%	-4%	-16%	14%	5%	4%
Investment securities	711,639	913,779	1,050,588	1,248,608	1,663,821	1,796,927	1,940,681	2,095,935
Fixed assets (PP&E)	88,557	88,398	88,315	88,263	91,515	90,517	87,719	83,122
Other assets	205,540	245,101	378,972	513,633	612,397	674,242	743,090	819,765
Total assets	4,343,737	4,166,189	4,736,805	5,236,537	5,568,316	6,176,793	6,576,879	6,999,903
Customer deposits	3,050,853	2,970,922	3,104,221	3,143,338	3,486,691	3,661,026	3,844,077	4,036,281
Other liabilities	387,199	351,339	723,507	983,288	1,196,842	1,214,979	1,234,246	1,254,791
Taxation	11,829	8,773	8,897	10,194	15,656	17,657	19,959	22,606
Deferred taxation	87	239	813	606	266	321	383	455
Borrowings	369,707	256,116	316,792	420,919	338,214	701,258	825,681	953,067
Total liabilities	3,819,675	3,587,389	4,154,230	4,558,345	5,037,669	5,595,240	5,924,347	6,267,200
Shareholders' Funds	520,029	575,125	583,123	683,686	518,229	568,646	639,087	718,666
Minority Interest	4,033	3,675	(548)	(5,494)	12,418	12,907	13,445	14,037
BVPS	16.1	17.7	17.9	18.9	16.3	17.8	20.0	22.5
<b>Ratios</b>								
Cost/income ratio ex prov.	66.5%	61.3%	47.0%	53.5%	63.4%	71.1%	65.2%	64.0%
Cost/income ratio	71.7%	91.2%	90.6%	80.8%	80.2%	78.7%	73.5%	72.7%
RoAA	2.0%	0.4%	0.3%	1.0%	1.1%	1.2%	1.5%	1.6%
RoAE	17.0%	2.8%	2.1%	7.5%	10.1%	12.8%	16.1%	16.2%
NPL ratio	2.7%	18.1%	20.0%	22.8%	25.8%	10.0%	10.0%	10.0%
Cost of risk	1.3%	5.7%	10.4%	5.7%	4.0%	1.9%	2.5%	2.8%
Leverage	8.4x	7.2x	8.1x	7.7x	10.7x	10.9x	10.3x	9.7x
Loan to deposit	69%	63%	68%	63%	49%	49%	48%	48%
Capital adequacy ratio (CAR)	17%	17%	18%	18%	16%	17%	17%	17%
Price to book ratio (x)	0.50	0.29	0.19	0.47	0.49	0.36	0.33	0.29
Price to earnings ratio	2.93	10.46	8.88	6.68	4.86	3.03	2.17	1.92
Dividend yield	1.3%	0.0%	6.0%	3.8%	6.4%	9.1%	12.7%	14.3%

Source: Company, Coronation Research

# UBA

UBA's pan-African franchise has continued to positively impact the bank's top and bottom lines, with international revenues making up approximately one third of total. With the replication of its Nigerian experience and diversification of earnings across different African markets we hold a positive outlook on the sustainability of its revenues.

## Interest income vs non-interest income

Over a five-year period, interest income accounted for 70.0% of the UBA's revenues while non-interest income accounts for the remaining 30.0%. The mix (2014-2019e), in our opinion, is ideal, given a deposit base of N3.5tn (US\$9.7bn) - the 4th largest in the Nigerian banking industry - at 2019e. In our opinion this positions the bank for loan growth. We think that non-performing loan (NPL) level, at 5.7% of gross loans at 9M 2019, is acceptable.

Total capital adequacy stood at 19.0% at 9M 2019 compared with the regulatory minimum of 16.0% for a strategically important bank.

Non-interest income has been growing over recent years, driven largely by rising penetration of digital banking offerings: over 2,500 ATM's; 24,000 PoS terminals and a robustness of self-service banking platforms which accounts for about 60.0% of UBA's transaction volume, according to management.

## Costs still an issue

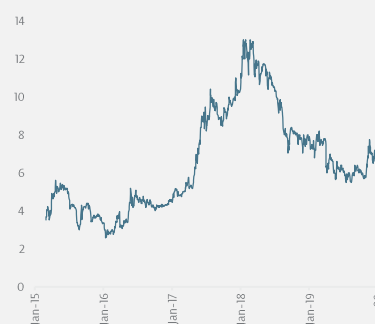
The weakness of UBA lies in its cost-to-income ratio which, at 60.8% in 9M 2019, is considerably higher than its peer group average at c.54.0%. We believe the cost of doing business across 23 different countries is the explanation for this, and the inevitable flipside of its diversification.

A further explanation is that UBA is a full employer of its staff as opposed to other top-tier commercial banks which make use of contract staff, giving it an edge in terms of salaries and incentives. It has recently announced several senior appointments and a significant adjustment to its permanent staffing levels.

Rating	Buy
Price (N)	8.85
Price target (N)	11.50
Up/downside potential	29.94%
Market cap (Nbn/US\$m)	266 / 732
Bloomberg	UBA:NL
Reuters	UBA.LG
Free float	87.33%

Priced at 08 January 2020

Share price performance (N)



Source: Bloomberg, Coronation Research

N millions	2019f	2020f	2021f
Net Interest Income	218,176	243,687	259,830
change	6%	12%	7%
Net F&C Income	82,540	102,027	127,033
change	26%	24%	25%
Operating Expenses	(218,249)	(228,215)	(241,127)
change	11%	5%	6%
Provisions			
Pre-Tax Profits	130,395	170,193	202,899
Profits After Tax	107,576	136,155	162,319
change	37%	27%	19%
RoE	20%	22%	22%
P/BV	0.5	0.5	0.4
PE	2.8	2.2	1.9

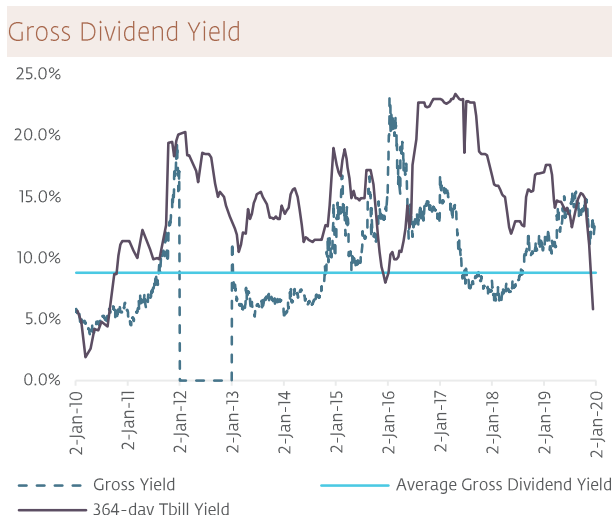
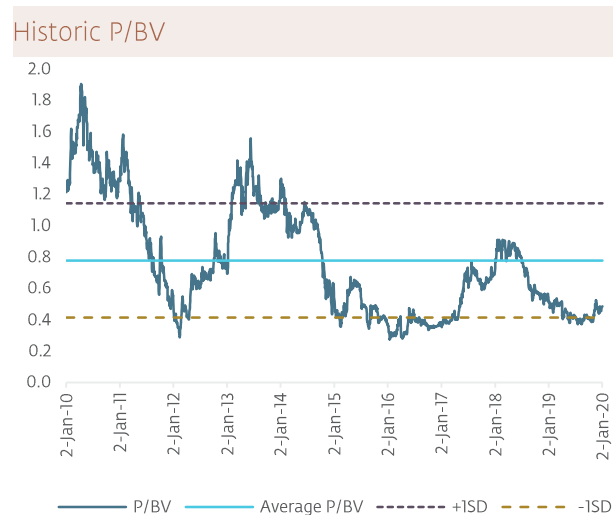
Source: Company, Coronation Research estimates, Operating Expenses = Personnel Expenses + Administrative Expenses + Depreciation (where this is broken out) + (other direct expenses where applicable), Priced at 08 January, 2020.

# UBA

## Loan book and capital adequacy

UBA has positively surprised analysts with its hold on asset quality over the last couple of years. We do not anticipate a significant deterioration in the bank’s loan book or cost of risk in 2020f. Oil and gas loans make up the biggest portion (c.40.0%) of the bank’s non-performing loans (NPL). With the oil price (Brent) currently trading at over US\$60.00/bbl and stability in the FX market, we think impairment provisions are a containable risk for at least 2020f.

The capital adequacy ratio of the bank, at 28.0% in 9M 2019 (well in excess of the regulatory minimum for a strategically important bank of 16.0%), gives the bank leeway to grow its asset base, in our opinion. The bank is adequately capitalised to grow risk assets to comply with the minimum 65.0% regulatory loan-to-deposit ratio - which requires banks to increase lending to stimulate the economy - in 2019e and 2020f, in our view.



Source: Bloomberg for prices, Coronation Research.

## Valuation

UBA currently has the second-highest gross dividend yield among the major listed banks, at 11.3%, which is a premium when compared with the 364-day T-bill yield at 5.8%. It makes sense, in our view, for investors to position themselves for a potential N1.0/s dividend on 2019e earnings and possible appreciation in share price.

Over several cycles, investors have paid an average of 0.78x P/BV for UBA and we think that the bank could trade at the level on a one-year view. We maintain a target price of N11.50/s.

# UBA: forecasts

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Income statement Nm	2014	2015	2016	2017	2018	2019e	2020f	2021f
Net Interest Income	106,133	133,599	165,200	207,632	205,646	218,176	243,687	259,830
Net Fee and Commission Income	47,966	53,335	59,211	65,970	65,446	82,540	102,027	127,033
Other Income	86,322	76,658	105,689	118,933	102,572	140,409	170,434	207,983
Loan loss & other provision	(6,578)	(5,053)	(27,683)	(32,895)	(4,529)	(9,941)	(15,713)	(23,787)
Operating expenses	(129,686)	(136,640)	(152,501)	(188,610)	(197,342)	(218,249)	(228,215)	(241,127)
Pretax profits	56,200	68,454	90,642	105,264	106,766	130,395	170,193	202,899
Effective tax rate	15%	13%	20%	25%	26%	18%	20%	20%
Net Profits	47,907	59,654	72,264	78,590	78,607	107,576	136,155	162,319
EPS (reported)	1.56	1.79	1.99	2.17	2.30	3.15	3.98	4.75
DPS	0.10	0.60	0.60	0.65	0.80	1.00	1.25	1.50
Payout ratio	6%	34%	30%	30%	35%	32%	31%	32%
Weighted Ave. Share Count	32,981	35,455	36,280	36,280	34,199	34,199	34,199	34,199

## Statement of financial position

Cash and balances with CBN	812,359	655,371	760,930	898,083	1,220,596	1,685,178	2,161,553	2,677,088
Loans and advances to Bank	48,093	14,600	22,765	20,640	15,797	16,019	16,241	16,463
Loans and advances to Customers	1,071,859	1,036,637	1,505,319	1,650,891	1,715,285	1,852,508	2,019,234	2,200,965
Investment securities	657,523	856,870	970,392	1,216,053	1,637,132	1,517,132	1,405,132	1,293,132
Fixed assets (PP&E)	89,517	88,825	93,932	107,636	115,973	114,241	111,908	106,577
Other assets	83,222	100,319	151,132	176,171	164,955	171,635	178,315	184,997
Total assets	2,762,573	2,752,622	3,504,470	4,069,474	4,869,738	5,356,712	5,892,383	6,479,221
Customer deposits	2,169,663	2,081,704	2,485,610	2,733,348	3,349,120	3,355,818	3,362,530	3,369,255
Other liabilities	123,737	116,278	219,690	231,034	295,699	306,765	318,268	330,230
Taxation	4,615	6,488	5,134	7,668	8,892	8,903	8,914	8,925
Deferred taxation	40	15	62	40	28	38	48	58
Long term liabilities/borrowings	199,112	215,516	345,905	567,950	713,391	1,108,553	1,531,932	1,988,392
Total liabilities	2,497,167	2,420,001	3,056,401	3,540,040	4,367,130	4,780,077	5,221,692	5,696,859
Shareholders' Funds	259,930	325,827	434,851	511,203	483,469	556,846	650,252	761,273
Minority Interest	5,476	6,794	13,218	18,231	19,139	19,789	20,439	21,089
BVPS	8.0	9.2	12.4	14.6	14.7	16.9	19.6	22.9

## Ratios

Cost/income ratio	67.4%	65.0%	56.3%	57.8%	64.0%	60.9%	55.1%	51.5%
Cost/income ratio ex prov.	69.8%	66.6%	62.7%	64.2%	65.0%	62.6%	57.3%	54.3%
Pre-tax margin	16.5%	18.9%	18.8%	17.0%	15.9%	18.9%	21.2%	22.7%
RoAA	1.8%	2.2%	2.3%	2.1%	1.8%	2.1%	2.4%	2.6%
RoAE	19.1%	20.0%	18.5%	16.1%	15.2%	19.9%	21.8%	22.3%
NPL ratio	1.6%	1.7%	2.5%	2.0%	6.5%	4.8%	4.5%	4.5%
Cost of risk	0.6%	0.5%	2.1%	2.2%	0.3%	0.5%	0.7%	1.0%
Leverage	0.9x	0.9x	0.9x	0.9x	0.9x	0.9x	0.9x	0.9x
Loan to deposit	49%	50%	61%	60%	54%	65%	69%	72%
Capital adequacy ratio (CAR)	16%	20%	22%	22%	24%	24%	22%	22%
Price to book ratio (x)	1.46	1.28	0.95	0.81	0.52	0.52	0.45	0.39
Price to earnings ratio	7.63	6.42	5.14	5.01	3.4	2.8	2.2	1.9
Dividend yield	0.9%	5.1%	5.1%	5.5%	10.4%	11.3%	14.1%	16.9%

Source: Company, Coronation Research



# Stanbic IBTC

The allure of Stanbic IBTC (Stanbic) consists of steady growth in income generation across most of its business segments. Its wealth and investment banking businesses give it a strong non-interest income line and to some extent shelters the bank's earnings volatility.

## We see quality earnings in the wealth business

Stanbic manages the largest pool of pension funds in Nigeria, with N3.63trillion (US\$7.2bn) in assets under management (AUM) at 9M 2019, and this has grown at a nominal CAGR of 20.0% over the last five years. We still see significant value in this segment and we forecast nominal growth of 21.5% per annum nominal during our forecast period. This business accounts for more than half of the bank's fees and commission line, 56.3% as at 9M 2019.

## Asset quality is healthy

The bank's non-performing loan (NPL) ratio fell from 3.9% in FY 2018 to 2.7% in 9M 2019, leading to a write-back of provisions of N90.0m at 9M 2019, rather than the usual loan loss provision we might usually expect. To be conservative, however, we estimate an impairment charge of N528.0m for FY 2019e.

## Lid on costs

Stanbic has the lowest cost-to-income ratio (reported at 50.9% in 9M 2019) among its peer group (c. 54.0% average). Its cost-to-income ratio has come down consistently over five years (it was 57.1% in 2014) and we see these gains as progressive and sustainable. A mid-term forecast RoAE of over 35.0% is, in our view, the highest among the banks we cover.

Rating	Buy
Price (N)	42.50
Price target (N)	61.35
Up/downside potential	44.35%
Market cap (Nbn/US\$m)	491 / 1,348
Bloomberg	STANBIC:NL
Reuters	IBTC.LG
Free float	28.63%

Priced at 08 January 2020

### Share price performance (N)



Source: Bloomberg, Coronation Research

N millions	2019f	2020f	2021f
Net Interest Income	78,591	81,937	85,222
change	0%	4%	4%
Net F&C Income	72,082	76,798	81,795
change	3%	7%	7%
Operating Expenses	(95,027)	(100,050)	(105,405)
change	-1%	5%	5%
Provisions	(528)	(1,253)	(1,378)
Pre-Tax Profits	93,374	102,029	112,239
Profits After Tax	74,699	86,725	95,403
change	0%	16%	10%
RoE	29%	28%	26%
P/BV	1.3	1.1	1.0
PE	5.2	4.5	4.1

Source: Company, Coronation Research estimates, Operating Expenses = Personnel Expenses + Administrative Expenses + Depreciation (where this is broken out) + (other direct expenses where applicable), Priced at 08 January, 2020.

# Stanbic IBTC

## Business segments

**Personal and Business Banking (PBB):** PBB has improved significantly since 2016. Total operating income grew by 23.1% and net profits by 112.3% between FY 2016 and (9M 2019). The positive we see is the growth in revenues from e-banking channels over the past year. We believe the bank could generate more income from this segment by deepening the penetration of alternative E-channels and increasing transaction volumes.

Cost control is also an area that needs to be addressed, in our view. PBB has an especially high cost to income ratio of 91.3%. Improvement in the PBB business, which often eats into group profits, would be very positive for Stanbic. We believe we may see a turnaround in this segment, though we think a double digit RoAE is still a couple of years away.

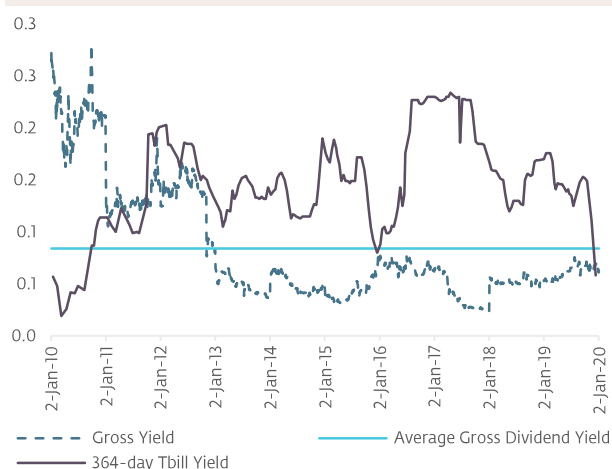
**Wealth:** Stanbic's Asset Under Management (AUM) has grown at a nominal CAGR of 20% over the last 5 years. Growth in AUM takes three forms: 1) contributions from existing customers; 2) return on investment for the AUM, and; 3) new customers. We believe the first two will be the key growth drivers for this segment, and we forecast AUM growing at an annual rate of 18%-22% over the coming three years.

**Corporate and Investment Banking (CIB):** We expect the strong profitability in the CIB business to be maintained, and the RoAE of 34.1% at 9M 2019 or something close to this level, be maintained.

### Historic P/BV



### Gross Dividend Yield



Source: Bloomberg, Coronation Research.

Stanbic currently has a gross dividend yield of 6.9%, a percentage point greater than the current 364-day T-bill yield at 5.8%. We think the gross dividend yield could increase to 8.3% at FY 2019e and 9.4% in 2020f.

Investing in Stanbic over the cycle has been a lesson in assessing growth rather than asset value, as its RoE has steadily improved over the years. Our target price is based on an implied price to book ratio of 1.80x to our 2020f BVPS of N34.0.

# Stanbic IBTC: forecasts

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Income statement Nm	2014	2015	2016	2017	2018	2019f	2020f	2021f
Net Interest Income	46,658	43,860	57,859	83,587	78,209	78,591	81,937	85,222
Net Fee and Commission Income	39,267	40,704	52,154	59,089	69,845	72,082	76,798	81,795
Other Income	18,677	16,084	16,040	30,093	32,759	38,256	44,597	52,005
Loan loss & other provision	(3,217)	(14,931)	(19,803)	(25,577)	2,940	(528)	(1,253)	(1,378)
Operating expenses	(61,315)	(62,066)	(69,041)	(86,026)	(95,601)	(95,027)	(100,050)	(105,405)
Pretax profits	40,070	23,651	37,209	61,166	88,152	93,374	102,029	112,239
Effective tax rate	21%	20%	23%	21%	16%	20%	15%	15%
Net Profits	32,065	18,891	28,520	48,381	74,440	74,699	86,725	95,403
Minority Interest	(2,772)	(2,163)	(2,163)	(2,379)	(2,353)	(2,588)	(2,847)	(3,132)
Net Profits to shareholders	29,293	16,728	26,357	46,002	72,087	72,111	83,878	92,271
EPS	2.93	1.67	2.64	4.60	7.04	6.86	7.98	8.78
DPS	0.10	0.95	0.05	1.21	1.82	2.49	3.05	3.63
Payout ratio	3%	57%	2%	26%	26%	36%	38%	41%
Weighted Ave. Share Count	10,000	10,000	10,000	10,000	10,240	10,505	10,505	10,505
<b>Statement of financial position</b>								
Cash and Short term funds	143,171	211,481	301,351	401,348	455,773	504,000	564,480	638,135
Due from banks	8,814	26,782	15,264	9,623	8,548	10,429	12,723	15,522
Loans and advances to Customers	398,604	353,513	352,965	372,088	432,713	575,748	633,323	696,655
Financial Investments	204,502	162,695	252,823	316,755	400,000	421,200	443,524	467,030
Fixed assets (PP&E)	24,004	25,311	22,962	21,883	21,652	22,813	23,015	22,256
Other assets	162,824	157,782	108,158	264,719	344,975	374,933	408,444	446,042
Total assets	944,542	937,564	1,053,523	1,386,416	1,663,661	1,909,122	2,085,508	2,285,641
Customer deposits	494,935	493,513	560,969	753,642	807,692	1,009,615	1,110,577	1,221,634
Other liabilities	232,434	201,431	218,200	331,258	470,753	508,413	549,086	593,013
Taxation & deferred taxation	9,774	8,847	9,555	12,360	15,036	15,637	16,263	16,913
Long term liabilities/borrowings	93,124	104,806	124,001	103,938	130,513	79,081	47,214	18,816
Total liabilities	830,267	808,597	912,725	1,201,198	1,423,994	1,612,746	1,723,140	1,850,376
Shareholders' Funds	110,052	123,726	137,102	182,060	235,406	291,513	356,903	429,196
Minority Interest	4,223	5,241	3,696	3,158	4,261	4,863	5,465	6,068
BVPS	11.6	12.4	13.7	18.2	23.0	27.8	34.0	40.9
<b>Ratios</b>								
Cost/income ratio ex provisions	55.3%	61.7%	54.8%	49.8%	52.9%	50.3%	49.1%	47.9%
Cost/income ratio	57.1%	72.4%	65.0%	58.4%	52.0%	50.4%	49.4%	48.2%
Pre-tax margin	33.3%	16.9%	23.8%	28.8%	39.6%	39.6%	38.9%	39.3%
RoAA	3.4%	1.8%	2.6%	3.8%	4.7%	4.0%	4.2%	4.3%
RoAE	32.8%	15.8%	21.9%	30.3%	35.7%	35.8%	36.5%	37.2%
NPLratio	4.3%	7.1%	5.0%	5.0%	4.0%	4.8%	4.7%	4.7%
Cost of risk	0.9%	3.7%	5.2%	5.0%	0.8%	0.1%	0.2%	0.2%
Leverage	8.6x	7.6x	7.7x	7.6x	7.1x	6.5x	5.8x	5.3x
Loan to deposit	82%	72%	63%	51%	54%	66%	66%	66%
Capital adequacy ratio (CAR)	20.0%	21.8%	22.8%	23.5%	24.7%	24.2%	25.0%	25.0%
Price to book ratio	4.18	3.92	3.54	2.66	2.09	1.33	1.80	0.96
Price to earnings ratio	12.76	24.87	16.18	8.79	5.85	5.2	4.5	4.1
Dividend yield	0.2%	2.0%	0.1%	2.5%	3.8%	6.9%	8.5%	10.1%

Source: Company, Coronation Research

# Fidelity Bank

Fidelity Bank (Fidelity) is not the most profitable of its peer group banks with a three-year average return on average equity (ROAE) of c.12.0%. However, it has maintained better asset quality, and capital ratios, than its peers among the mid-cap listed banks.

## Profit Development

Fidelity's returns are constrained by cost inefficiencies, we believe, and low (as a percentage of total income) non-interest income. While Fidelity's returns do not screen that well, we believe that there is considerable scope for improvement.

The regulatory 60.0% minimum loan-to-deposit ratio led to 26.9% growth in gross customer loan growth in 9M 2019. In our view, a significant constraint to further loan growth is Fidelity's capital adequacy ratio of 16.4% at 9M 2019 compared with a regulatory minimum of 15.0% for an international bank. While we anticipate moderation in asset yields, we do not necessarily anticipate a significant decline in income in 2019e and 2020f.

## Retail strategy

The high take-up rate of Fidelity's mobile and electronic banking services has been instrumental in its retail business. 42.6% of the banks customers are enrolled on its mobile & electronic platforms and 82.0% of all transactions are carried on this platform, according to management.

Although this is undoubtedly connected with gains in Net Fee & Commission Income, it also encourages us to be cautious about the development of this line in 2020f, if a degree of saturation has been reached. Even with a high level of penetration the proportion of non-interest income in total income remains low

Rating	Hold
Price (N)	2.02
Price target (N)	2.50
Up/downside potential	23.7%
Market cap (Nbn/US\$m)	58 / 161
Bloomberg	FIDELITY:NL
Reuters	FIDELIT.LG
Free float	98.6%

Priced at 08 January 2020

Share price performance (N)



Source: Bloomberg, Coronation Research

N millions	2019e	2020f	2020f
Net Interest Income	77,106	100,645	111,585
change	11%	31%	11%
Net F&C Income	17,592	18,133	18,690
change	3%	3%	3%
Operating Expenses	(74,575)	(77,937)	(81,439)
change	3%	5%	4%
Provisions	5,100	(3,655)	(4,203)
Pre-Tax Profits	31,232	43,385	51,025
Profits After Tax	28,109	35,576	41,840
change	23%	27%	18%
RoE	15%	16%	17%
P/BV	0.3	0.3	0.2
PE	2.2	1.7	1.5

Source: Company, Coronation Research estimates, Operating Expenses = Personnel Expenses + Administrative Expenses + Depreciation (where this is broken out) + (other direct expenses where applicable). Priced at 08 January, 2020.

# Fidelity Bank

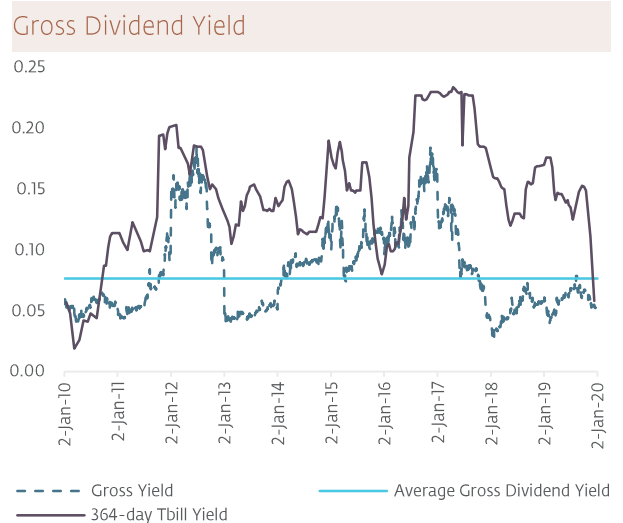
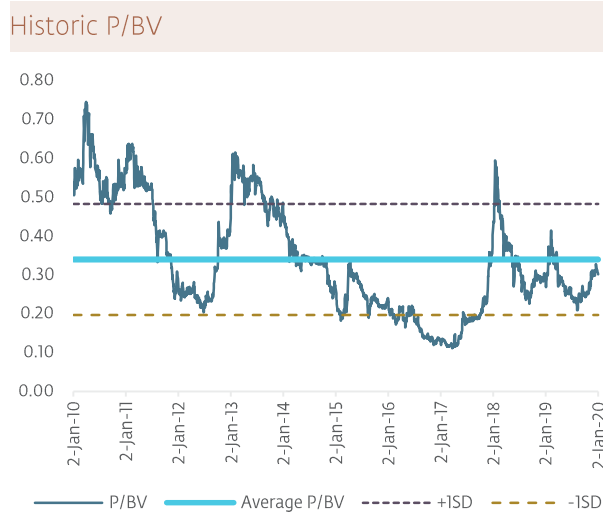
## Asset quality

As at 9M 2019 Fidelity booked a positive loan loss provision due to a N4.8bn write-back from previously-impaired loans. The non-performing loan (NPL) ratio trended downward from 5.7% at FY 2018 to 4.8% at 9M 2019, below the regulatory benchmark of 5.0%. We do not foresee the bank's cost of risk (CoR) being more than 0.5% in 2020f and 2021f.

## Valuation

Investors in Fidelity have seen a steadily-increasing RoAE, albeit from a low base. We estimate 14.5% for 2019e and forecast 16.3% for 2020f.

Fidelity currently has a gross dividend yield of 5.8%, at par with the current 364-day T-bill. We think the gross dividend yield could increase to 7.1% for FY 2019e and 9.5% for 2020f.



Source: Bloomberg, Coronation Research.

Fidelity currently trades at its nine-years average P/BV, we think the stock is fairly valued at this level and set a target price of N2.50/s and a Hold recommendation.

# Fidelity Bank: forecasts

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Income statement Nm	2014	2015	2016	2017	2018	2019e	2020f	2021f
Net Interest Income	48,826	60,864	61,928	71,464	69,587	77,106	100,645	111,585
Net Fee and Commission Income	17,189	14,826	17,319	14,555	17,064	17,592	18,133	18,690
Other Income	10,905	8,262	7,686	11,273	14,781	6,010	6,198	6,392
Loan loss & other provision	(4,306)	(5,764)	(8,671)	(11,315)	(4,215)	5,100	(3,655)	(4,203)
Operating expenses	(57,099)	(64,164)	(67,201)	(65,675)	(72,128)	(74,575)	(77,937)	(81,439)
Pretax profits	15,515	14,024	11,061	20,302	25,089	31,232	43,385	51,025
Effective tax rate	11%	1%	12%	7%	9%	10%	18%	18%
Net Profits	13,796	13,904	9,734	18,857	22,926	28,109	35,576	41,840
EPS (reported)	0.48	0.48	0.34	0.65	0.79	0.97	1.23	1.44
DPS	0.18	0.16	0.14	0.14	0.11	0.15	0.20	0.20
Payout ratio	38%	33%	42%	22%	14%	15%	16%	14%
Dividend sum	5,213	4,634	4,055	4,055	3,186	4,344	5,793	5,793
Weighted Ave. Share Count	28,963	28,963	28,963	28,963	28,963	28,963	28,963	28,963
<b>Statement of financial position</b>								
Cash, balances with Central Banks	258,131	185,332	207,061	269,625	384,931	485,325	560,213	679,956
Loans and advances to Bank	68,735	79,942	49,200	52,287	111,633	118,619	126,042	133,930
Loans and advances to Customers	541,686	578,203	718,401	768,737	849,880	1,068,149	1,231,852	1,420,109
Investment securities	243,753	301,413	244,818	206,238	290,353	314,549	340,974	369,847
Fixed assets (PP&E)	37,958	39,985	40,356	38,504	36,909	39,862	43,051	46,495
Other assets	36,762	46,847	38,305	43,823	46,177	50,690	55,654	61,114
Total assets	1,187,025	1,231,722	1,298,141	1,379,214	1,719,883	2,077,194	2,357,786	2,711,452
Customer deposits	820,034	769,636	792,971	775,276	979,413	1,126,325	1,182,641	1,241,773
Other liabilities	73,210	134,263	159,406	185,945	300,335	327,619	357,306	389,617
Taxation	1,719	2,332	1,327	1,445	1,609	2,181	2,753	3,325
Deferred taxation	1,410	0	0	0	0	0	0	0
Long term liabilities/borrowings	117,541	141,975	159,035	213,233	244,110	402,889	567,122	792,725
Total liabilities	1,013,914	1,048,206	1,112,739	1,175,899	1,525,467	1,859,014	2,109,822	2,427,440
Shareholders' Funds	173,111	183,516	185,402	203,315	194,416	218,180	247,964	284,012
Minority Interest	0	0	0	0	0	0	0	0
BVPS	6.0	6.3	6.4	7.0	6.7	7.5	8.6	9.8
<b>Ratios</b>								
Net interest margin	5.8%	6.7%	6.3%	7.0%	6.1%	5.6%	6.3%	6.2%
Cost/income ratio	74.2%	76.4%	77.3%	67.5%	71.1%	70.5%	64.2%	61.5%
Pre-tax margin	11.7%	9.5%	7.3%	11.3%	13.3%	15.5%	18.7%	19.7%
RoAA	1.2%	1.1%	0.8%	1.4%	1.5%	1.5%	1.6%	1.7%
RoAE	8.4%	8.0%	5.3%	10.2%	11.3%	14.5%	16.3%	16.9%
Cost of risk	0.9%	1.0%	1.3%	1.7%	0.7%	-0.5%	0.3%	0.3%
Leverage	1.2x	1.2x	1.2x	1.2x	1.1x	1.1x	1.1x	1.1x
Loan to deposit	68%	78%	94%	104%				
Capital adequacy ratio (CAR)	23%	19%	17%	20%	17%	17%	18%	18%
Price to book ratio	0.45	0.42	0.42	0.38	0.30	0.28	0.25	0.21
Price to earnings ratio	5.31	5.27	7.89	3.75	2.68	2.2	1.7	1.5
Dividend yield	6.7%	6.0%	5.2%	5.2%	5.4%	7.1%	9.5%	9.5%

Source: Company, Coronation Research

# Sterling Bank

## Profitability

Sterling Bank's (Sterling) profitability is held back by its weak non-interest income and operational inefficiencies, in our view. Its high cost-to-income ratio of 82.9% (at 9M 2019), compared with the peer average of 54.0%, is the main drag on earnings. Our prognosis for Sterling is that, without a reduction in its expenses, its cost-to-income ratio will likely remain very high, and improvements in the bank's income may not translate into an RoAE that is comparable with its peers.

The bank's net interest margin (NIM) screens well compared with peers but its weak non-interest income provides little support for total operating income.

Sterling, through a series of note issuances, has been able to address its capital issues. The bank's total capital adequacy ratio (CAR), was reported at 13.9% at 9M 2019, against a regulatory minimum of 10.0% for national banks. This increase in capital gave headroom for loan growth in 2019e, in our view.

## Asset quality – no cause for alarm

Sterling's non-performing loan (NPL) and cost of risk (CoR) ratios both improved in Q3 2019. The NPL ratio was, at that stage, just above the regulatory limit 5.0%, at 6.1%. We do not think the bank's credit exposure has deteriorated significantly in 2019e nor will deteriorate in 2020f because of its declining exposure to the oil and gas sector combined with stable oil prices.

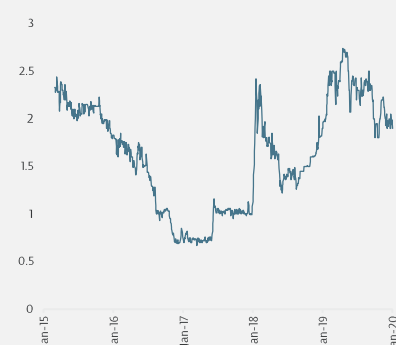
## We see some positives, however

Sterling, in our view, has been trying to reposition itself over the last two years through rebranding. While this is yet to translate into significant growth in earnings, we believe this will be positive for the bank's deposit generation in the medium term.

Rating	Hold
Price (N)	2.00
Price target (N)	1.90
Up/downside potential	0.0%
Market cap (Nbn/US\$m)	54 / 150
Bloomberg	STERLNBA:NL
Reuters	STERLNB.LG
Free float	46.2%

Priced at 08 January 2020

Share price performance (N)



Source: Bloomberg, Coronation Research

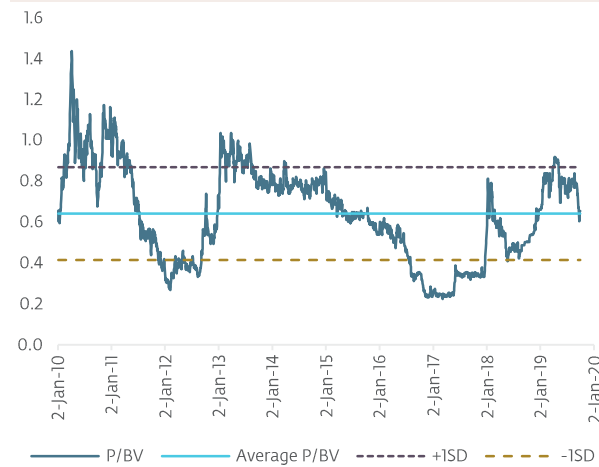
N millions	2019f	2020f	2020f
Net Interest Income	63,808	66,989	66,251
change	15%	5%	-1%
Net F&C Income	18,253	20,079	22,086
change	20%	10%	10%
Operating Expenses	(69,787)	(75,370)	(82,153)
change	4%	8%	9%
Provisions	(5,510)	(6,336)	(7,287)
Pre-Tax Profits	13,316	13,679	9,463
Profits After Tax	10,919	11,217	7,759
change	18%	3%	-31%
RoE	10.7%	11.5%	12.3%
P/BV	0.6	0.5	0.5
PE	5.4	5.3	7.6

Source: Company, Coronation Research estimates, Operating Expenses = Personnel Expenses + Administrative Expenses + Depreciation (where this is broken out) + (other direct expenses where applicable). Priced at 08 January, 2020.

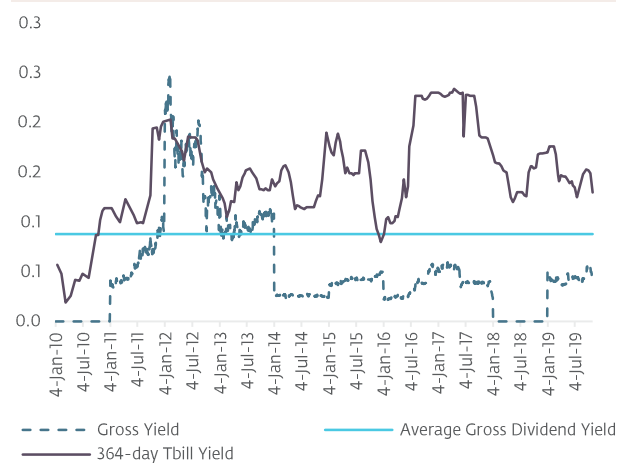
# Sterling Bank

Since Sterling has addressed its capital issues, we forecast a dividend per share of 10kobo for FY 2019e. This brings an approximate 5.0% gross dividend yield, almost a percentage point lower than the current 364-day T-bill yield at 5.8%.

Historic P/BV



Gross Dividend Yield



Source: Bloomberg, Coronation Research.

Sterling currently trades at its nine-year average P/BV, we think the stock is fairly valued at this level and do not think the market will rate the stock above this level given a low medium term RoAE outlook. We set a price target of N1.90/s.



# Sterling Bank: forecasts

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Income statement Nm	2014	2015	2016	2017	2018	2019e	2020f	2021f
Net Interest Income	43,017	39,542	55,989	52,357	55,281	63,808	66,989	66,251
Net Fee and Commission Income	16,133	15,522	10,788	12,083	15,211	18,253	20,079	22,086
Other non-interest Income	9,614	13,763	1,548	4,879	11,790	6,550	8,317	10,565
Loan loss & other provision	(7,389)	(8,151)	(11,714)	(10,488)	(5,843)	(5,510)	(6,336)	(7,287)
Operating expenses	(50,627)	(49,659)	(50,611)	(50,713)	(66,950)	(69,787)	(75,370)	(82,153)
Pretax profits	10,748	11,016	6,000	8,118	9,489	13,316	13,679	9,463
Effective tax rate	16%	7%	14%	12%	3%	18%	18%	18%
Net Profits	9,005	10,293	5,162	7,144	9,218	10,919	11,217	7,759
EPS	0.31	0.36	0.18	0.25	0.32	0.38	0.39	0.27
DPS	0.06	0.09	0.04	0.06	0.00	0.10	0.10	0.15
Payout ratio	19%	25%	25%	25%	0%	25%	25%	25%
Dividend sum	1,727	2,591	1,291	1,786	0	2,879	2,879	4,319
Share Outstanding	28,790	28,790	28,790	28,790	28,790	28,790	28,790	28,790
<b>Statement of financial position</b>								
Cash and balances with CBN	174,760	115,924	107,859	115,000	117,685	177,520	185,426	262,451
Loans and advances to Bank	67,330	68,799	31,289	39,455	43,542	45,719	48,005	50,405
Loans and advances to Customers	371,246	338,726	468,250	561,900	621,017	713,187	818,985	940,417
Investment securities	96,571	169,532	94,632	102,154	248,827	267,067	286,805	308,174
Fixed assets (PP&E)	13,952	15,258	14,604	14,794	16,942	17,450	17,974	18,513
Other assets	100,680	91,212	117,556	153,915	54,908	57,659	60,563	63,628
Total assets	824,539	799,451	834,190	987,218	1,102,921	1,278,602	1,417,757	1,643,588
Customer deposits	655,944	590,889	584,734	578,887	760,608	950,760	1,188,450	1,485,563
Other liabilities	32,143	47,367	65,022	82,760	37,973	44,428	51,981	60,818
Taxation	1,802	780	942	1,088	405	437	472	510
Long term liabilities/borrowings	49,935	64,849	97,832	233,465	206,135	176,258	60,900	(23,612)
Total liabilities	739,824	703,886	748,530	896,200	1,005,121	1,171,883	1,301,804	1,523,279
Shareholders' Funds	84,715	95,566	85,660	91,018	97,800	106,719	115,953	120,309
Minority Interest	0	0	0	0	0	0	0	0
BVPS	2.9	3.3	3.0	3.2	3.4	3.7	4.0	4.2
<b>Ratios</b>								
Net interest margin	7.2%	6.3%	8.4%	7.0%	6.0%	6.5%	6.1%	5.3%
Cost/income ratio	82.5%	81.8%	89.4%	86.2%	87.6%	84.0%	84.6%	89.7%
Cost/income ratio ex prov.	73.6%	72.2%	74.1%	73.2%	81.4%	78.8%	79.0%	83.1%
Pre-tax margin	10.4%	10.0%	5.4%	6.6%	6.2%	8.8%	8.2%	5.2%
RoAA	1.2%	1.3%	0.6%	0.8%	0.8%	0.9%	0.8%	0.5%
RoAE	12.2%	11.4%	5.7%	8.1%	9.2%	10.7%	11.5%	12.3%
NPL ratio	3.1%	4.8%	9.9%	8.0%	8.7%	5.0%	4.5%	4.5%
Cost of risk	1.9%	2.3%	2.5%	2.0%	0.9%	0.8%	0.8%	0.8%
<b>Price to book ratio</b>								
Price to book ratio	0.59	0.53	0.59	0.49	0.56	0.55	0.51	0.49
<b>Price to earnings ratio</b>								
Price to earnings ratio	4.89	4.62	10.32	5.42	6.09	5.4	5.3	7.6
<b>Dividend yield</b>								
Dividend yield	3.5%	5.2%	2.6%	3.6%	0.0%	5.0%	5.0%	7.5%

Source: Company, Coronation Research

# Risks

Risks to our investment thesis are evident in: exchange rates, in particular the Naira / US dollar exchange rate; oil prices and production; ongoing insurgencies; regulatory risk; development of non-performing loans; macro-economic risk; market risk; interest rate conditions; management decisions as they affect the performance of companies and banks.

## Naira/US dollar exchange rate

In 2019 the unofficial, or parallel Naira/US\$ and the interbank Naira/US\$ rate were not far apart, at around N360.00/US\$. The Naira/US\$ rate was considerably stable, in our view, but the published foreign exchange reserves of the Central Bank of Nigeria (CBN) declined from US\$43.17bn in January 2019 to US\$38.60bn in December 2019.

However, inflation (November 2019: 11.85% year-on-year) represents an ongoing and potent threat to the exchange rate, which continues to be protected by various restrictive rules and controls. The Naira/US dollar exchange rate used in preparing forecasts in this report is N362.50/US\$1, but there remains a risk that this exchange rate could change.

In addition, and over the long term, the Naira/US dollar exchange rate has been subject to periodic dislocations. During periods of severe exchange rate disruption there can be limitation on capital flows and foreign exchange transfers.

A Naira devaluation would negatively impact the profitability, asset quality and capital ratios of the banks covered in this report, given the volume of US dollar-denominated loans which they hold.

## Oil prices and production

The average price of oil (Brent) in 2018 was US\$71.69/bbl, in 2019 it was US\$64.04/bbl. However, recent prices have been stable at around US\$60.00/bbl. The Nigerian economy, and the companies and banks covered in this report, depend on oil prices and production to a significant extent.

A combination of a fall in oil prices and/or a steep fall in Nigerian oil production would threaten the export profile of Nigeria, which would have knock-on effects on its trade and current accounts, and therefore potentially impact the Naira/US dollar exchange rate, and on government revenues since these are largely derived from oil & gas.

Most of the banks covered in this report are significant lenders to the oil & gas sector, or to companies which themselves trade with or depend upon oil & gas companies. Therefore, a steep and sustained fall in the price of oil would result in losses at these companies, resulting in rising non-performing loans (NPL) and cost of risk (CoR) which would negatively impact banks.

## Regulatory Risk

The principal regulator of the banks covered in this report is the Central Bank of Nigeria (CBN). Alongside its foreign exchange, interest-rate, liquidity management and oversight functions, the CBN regulates such matters as minimum interest rates payable on savings accounts, maximum fees payable on card transactions, and other matters designed to benefit bank customers. The CBN also sets rules for minimum capital adequacy, minimum liquidity, and sets the cash reserve requirement (CRR). The CBN could change any of these rules which could impact the profitability and/or the liquidity and capital ratios of the companies and banks covered in this report.

# Risks

## Development of non-performing loans (NPL)

Throughout this report the authors refer to the level of non-performing loans (NPL) and the associate cost of risk (CoR) carried by banks. NPLs are inherently unpredictable. While strong oil prices (for example, above US\$60.00/bbl), foreign exchange stability and economic growth generally reduce the accumulation of NPLs and the generation of CoR, these factors do not rule out the risk of rising NPLs and CoR.

## Macro-economic risk

The authors of this report expect continued growth of the Nigerian economy during the forecast period but cannot rule out a return to recession. Such a renewed downturn would have negative effects on the profitability of the banks featured in this report.

## Market risk

Some of the banks covered in this report may in future access the Naira bond market or the international eurobond market for their financing needs. Conditions in these markets may change for the worse and negatively affect the ability of those banks to finance themselves, whether in those markets or via commercial loans which take those markets as their reference point.

The prices of shares listed on the Nigerian Stock Exchange (NSE) are subject to volatility which exceeds that of some developed and emerging markets. While volatility does not equate to risk, as such, market participants may reduce their participation in the Nigerian market if volatility reaches high levels, and this could negatively impact the share prices of the banks covered in this report.

## Political risk - insurgencies

The author(s) of this report are aware of three areas of insurgency in Nigeria: in the north-east of the country, where the so-called 'Boko Haram' group wages a terrorist campaign; in the south-south, particularly the Niger Delta area, where various groups disrupt oil & gas production; in the middle belt where traditional herdsmen have turned to violent confrontation with settled farmers. These insurgencies are chronic and, if any one or more of them worsen, could significantly disrupt the politics and economy of Nigeria.

## Interest rate conditions

The Central Bank of Nigeria (CBN) actively participates in Nigeria's interest rate markets in order to manage liquidity, and it sets the Monetary Policy Rate (MPR) for the banking sector. Interest rates are also driven by market demand for such products as Naira-denominated treasury bills (T-bills) and bonds, issued by the Federal Government of Nigeria (FGN) and the CBN's own open market operation (OMO) paper. Either by the design of the CBN, or through market conditions (for example, a sudden drop in demand for government and CBN securities) interest rates could change rapidly. Such rapid changes in interest rates could have negative implications for the banks covered in this report.

## Management decisions

Nigerian banks are closely monitored by the CBN and are required to adhere to a broad framework of strictly-enforced rules. Managers of Nigerian banks are required to have professional qualifications and experience. Nevertheless, past crises in Nigerian banking have exposed flawed decision making and such issues cannot be ruled out in future.

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Security Name	Available Disclosure
Nestle Nigeria	
Flour Mills of Nigeria	G
Unilever Nigeria	G
PZ Cussons Nigeria	G

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### Ratings and Price target history

	Date	Recommendation	Date	Recommendation	Date	Recommendation	Current price, Naira/s	Target price, Naira/s
Zenith	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	21.80	27.50
GT Bank	02-Jan-19	Hold	08-May-19	Hold	08-Jan-20	Buy	31.25	37.50
Access	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	10.30	11.25
FBNH	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	6.50	12.50
UBA	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	8.85	11.50
Stanbic IBTC	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	42.50	61.35
Fidelity	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Hold	2.02	2.50
Sterling	02-Jan-19	Hold	08-May-19	Hold	08-Jan-20	Hold	2.00	1.90

	Date	Recommendation	Current Price, Naira/s	Target price, Naira/s
Nestle Nig.	17-May-19	Hold	1,300	1,213.89
Flour Mills of Nig.	17-May-19	Hold	13.50	18.29
Unilever Nig.	17-May-19	Hold	29.45	28.39
PZ Cussons Nig.	17-May-19	Hold	5.90	8.22

This documents marks the initiation of coverage by Coronation Research for Nestle Nigeria, Flour Mills of Nigeria, Unilever Nigeria and PZ Cussons Nigeria.

Coronation Research Investment Rating Distribution	
Buy	66.7%
Sell	0%
Hold	33.3%
Under Review	0%

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