

## Performance Succumbs to Pressure in Q1:2020

### Earnings Constrained by Weak Asset Growth

Sterling Bank (STERLN BANK)'s gross earnings fell considerably by 6.67% YoY to NGN32.92bn in Q1:2020. Interest income which constitutes a major part of gross income (c.87%) declined by 7.77% YoY to NGN28.40bn. For this, we acknowledge the impact of regulatory headwinds on the bank's core business earnings however, the decline in interest earning assets (-13.86% YtD to NGN1.21trn) was also a significant downside factor. Much of the growth in the bank's balance sheet was sterilized in additional cash reserves with CBN (totaling NGN71.50bn), as result of the hike in Cash Reserve Ratio (CRR), leaving little room for expansion of interest-earning assets. On the flip side, non-interest income inched upwards (+0.89% YoY) to NGN4.52bn. This was supported by trading gains (+126.21% YoY), due to the higher prices of its debt securities in the secondary market albeit, the downward revision of bank charges led to a decline (-19.24% YoY) in gross fees and commission income to NGN3.95bn. **In view of the significant impediments to topline growth viz. regulatory risks, weak asset growth, and COVID-19-induced recessionary pressures, we project a modest (-1.60% YoY) contraction in gross earnings for 2020FY.**

### Income Losses Overshadow Cost Gains

Cost of funds declined to 5.10% (vs. 6.60% in Q1:2019), owing to the bank's growing preference for cheaper funding – CASA mix improved to 64.00% (vs. 60.00% in Q1:2019). The lower funding costs however did not translate to an expansion in net interest margin as the fall in asset yield (from 14.40% in Q1:2019 to 12.90%) eroded all gains. Hence, net interest margin contracted to 7.70% (vs. 7.80% in Q1:2019). Furthermore, the spike (+41.04% YoY) in impairment charges to NGN1.19bn increased pressure on bottom line performance. **It should however be noted that higher impairment charges have been observed across the industry in Q1:2020, due to a worsening in the country's macroeconomic conditions.** Operating cost inefficiency remains a major drag on the bank's performance, as operating expenses (OPEX) advanced further by 8.29% YoY, while Cost-to-income ratio also ticked up to 82.90%, from 78.80% in Q1:2019. Consequently, both Profit Before Tax (PBT) and Profit after tax (PAT) fell by 32.20% YoY and 36.27% YoY to NGN2.22bn and NGN2.07bn, respectively. **Going forward, we expect its reduced funding cost and a slightly lower OPEX growth (due to the impact of COVID-19) to offset the impact of depressed earnings and higher impairment charges, which should keep bottom line afloat.**

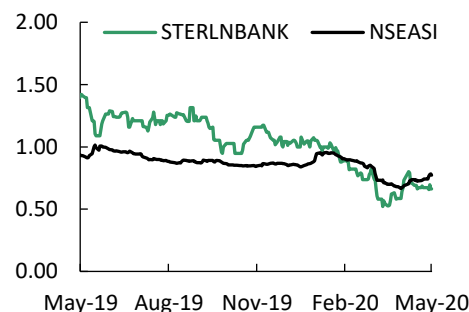
### CRR Debits Threaten Liquidity Position

As indicated earlier, the higher CRR debits (NGN71.50bn) incurred during the period significantly raised its effective CRR to 21.55% (from 13.68% in 2019FY) and drove net operating cashflows for the period deep into negative territory (- NGN62.88bn). Consequently, its liquidity ratio fell to 32.10% (vs. 39.50% in 2019FY), marginally above the regulatory benchmark (30%). We view the further decline in the bank's non-performing loan ratio to 2.00% (from. 2.20% in 2019FY), as a welcome development given the weak economic backdrop. All other prudential ratios stayed above regulatory benchmarks.

### Recommendation

We maintain our muted outlook for the bank in 2020FY in view of the anticipated consequences of COVID-19 on the general economy. Its lower earning asset base, tight liquidity position and high operating cost profile do not offer any competitive advantages. Thus, we revise our target P/E for the bank to **4.58x** (prev. **4.71x**) and its expected **EPS** to **NGN0.36** (prev. **NGN0.39**). This yields a Target Price of **NGN1.65**, indicating an upside potential of **28.81%**. Thus, we rate the ticker a **BUY**.

Company	STERLN BANK
<b>Valuation</b>	
Trailing EPS	0.33
BVPS	3.87
P/E	3.82x
P/BV	0.33x
Target PE	4.58x
Dec-2020 Exp. EPS	0.36
Dec 2020 Target price	<b>1.65</b>
Current Price	1.28
Up/Downside Potential	+28.81%
<b>Ratings</b>	<b>BUY</b>
<b>Key metrics</b>	
ROE	7.10%
ROA	0.70%
Net margin	6.27%
Asset Turnover	0.13x
Leverage	9.89x
<b>Share/Share Price Statistics</b>	
Yr Hi	NGN2.40
Yr Lo	NGN0.99
YTD return	-36.68%
Beta	1.28
Adjusted Beta	1.19
52-wk average volume	9,971,965
Shares outstanding	28.79bn
Market cap [NGN]	36.28bn
Financial year end	December
Most Recent Period (MRP)	Q1:2020



## Chart 1: Sensitivity Analysis

Sensitivity Analysis of Dec-2020 Target Price to key model inputs						Min	0.61
EPS						Max	3.06
Target PE		0.32	0.34	0.36	0.38	0.40	
	1.91x	0.61	0.65	0.69	0.73	0.76	
	3.22x	1.03	1.09	1.16	1.22	1.29	
	4.58x	1.47	1.56	1.65	1.74	1.83	
	6.08x	1.95	2.07	2.19	2.31	2.43	
	7.64x	2.44	2.60	2.75	2.90	3.06	

Financial Highlights (NGN billion) STERLING BANK PLC Q1:2020 Result			
Profit & Loss Account	Q1:2020	Q1:2019	y/y Growth
Gross Earnings	32.92	35.27	-6.67%
Interest Income	28.40	30.79	-7.77%
Interest Expense	12.95	15.86	-18.37%
Loan Loss Expense	1.19	0.84	41.04%
Net Interest income after impairment charges	14.26	14.09	1.24%
Non-Interest Income	4.52	4.48	0.89%
Operating Income	18.78	18.57	1.15%
OPEX	16.56	15.29	8.29%
PBT	2.22	3.27	-32.20%
PAT	2.07	3.24	-36.27%
Balance Sheet	Q1:2020	2019FY	
Cash and short-term funds	241.93	156.06	55.03%
Loans and Advances to customers	627.12	618.73	1.36%
Investment Securities (incl. pledged assets)	268.65	268.83	-0.07%
Property and Equipment	17.61	18.48	-4.68%
Other Assets	76.00	120.58	-36.97%
<b>Total Assets</b>	<b>1,231.32</b>	<b>1,182.69</b>	<b>4.11%</b>
Deposits from customers	898.58	892.66	0.66%
Financial Liabilities	122.23	125.36	-2.49%
Other Liabilities	95.31	45.11	111.28%
Total Liabilities	1,116.11	1,063.13	4.98%
Shareholders' fund	115.21	119.56	-3.64%

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**Company Name:** Sterling Bank Plc.

Date	Price (N)	Previous Target Price(N)	New Target Price (N)	Previous Recommendation	New Recommendation
01-Apr-2020	1.15	2.06	1.84	SELL	BUY
11-May-2020	1.28	1.84	1.65	BUY	BUY

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Sterling Bank Plc	

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