Banking Sector Update | November 2022

...In Search of New Opportunities

Introduction

As is typical, the Nigerian banking sector has been clogged with various activities this year, such as the increase in interest rate, acquisitions and establishment of new subsidiaries, limited credit creation ability (due to the heightened macroeconomic uncertainties and increase in cash reserve ratio), and mixed investors' sentiment towards the banking tickers. However, amidst these events, the banks have remained resilient, as they consistently seek initiatives to create value for stakeholders and play a pivotal role in driving the Nigerian economy. In this report, we discussed the industry's regulatory environment and recent corporate actions, assessed the financial performance of our coverage banks, analyzed investors' sentiment towards the tickers, and highlighted opportunities for investors.

The Regulatory Environment:

Tons of Policies Pressure Banks' Operations

In line with previous trends, the Nigerian banking industry - arguably the most regulated sector in the country – has faced a harsh regulatory environment in 2022. A myriad of policies was announced by the industry's regulator and the country's apex bank, the Central Bank of Nigeria (CBN). However, these same policies tested the resilience of Nigerian banks. Some policies introduced during the year which have had a direct impact on banks' operations include the planned discontinuance of FX supply to the banks by December 2022, the increase in the Cash Reserve Ratio (CRR) in September, and the continued excessive CRR charges.

Specifically, the hike in both MPR and CRR by 400bps and 500bps (to 15.50% and 32.50%, respectively) leaves the bank in a pain-and-gain situation. On one hand, the increased MPR presents an opportunity for banks to reprice their loans with customers to reflect the current market realities and higher yields on investment securities. On the other hand, a higher MPR would result in higher funding costs (as deposit rates are anchored on the MPR). Also, higher CRR results in lower system liquidity, which limits the banks' credit creation ability. Furthermore, in a sequel to the new CRR for banks, the CBN charged about ten (10) banks a total sum of NGN44.80bn for CRR debit. Put together, these actions could cause a strain on the banks' operations and profitability.

Overall, we recommend more flexibility in implementing and executing regulations in the sector. This encourages a more enabling business environment for Nigerian banks to operate.

Corporate Actions:

Universal Banking License Avails More Opportunities

One of CBN's initiatives in recent years is the resurgence of the universal banking license. Some Nigerian banks have taken the opportunity to expand their operations across non-banking financial services both organically and inorganically. At the forefront of this wave are Access Holdings Plc. (**ACCESSCORP**), Guaranty Trust Company Holding Plc. (**GTCO**), Stanbic IBTC Holdings Plc. (**STANBIC**), and FBN Holdings Plc (**FBNH**). **The table below details the most recent significant corporate actions in the Nigerian banking industry so far in 2022 and our assessment of the likely impacts.**

Bank	Transaction	Implication
ACCESSCORP	Acquisition of Sidian bank (Kenya)	Increased market share in Kenya and expansion of business operations outside Nigeria.
	Acquisition of First Pension Guarantee Limited	Expansion of financial service offerings and diversification of income sources.
	Establishment of a payment subsidiary (Hydrogen)	We expect this to diversify the company's revenue stream further and improve nonfunded income.
	Acquisition of Finibanco Angola S.A.	The acquisition is projected to contribute to the group's growth and financial performance in the long term.
	Acquisition of Sigma Pensions Limited	This is expected to improve the group's non-interest income.
FIDELITYBK	Acquisition of Union Bank UK Plc.	Business expansion beyond Nigeria.
FBNH	Acquisition of Access Pension Custodian Limited	We expect this to diversify the group's income streams and support gross earnings.
GTCO	Acquisition of Investment One Pensions Managers Limited and Investment One Funds Management Limited.	This acquisition is expected to improve the group's non-interest income.
	Establishment of a payment subsidiary (HabariPay)	We expect this to diversify the company's revenue stream further and improve nonfunded income.
POLARIS BANK	Sale to Strategic Capital Investment Limited	We project that the buyers' expertise should be an advantage for the bank in the long term.

STANBIC	Establishment of a FinTech subsidiary	We expect this to improve the company's fees and commission income.
TITAN TRUST BANK	Acquisition of Union Bank of Nigeria (**UBN**)	We expect the acquisition to expand the bank's businesses by leveraging its technological strength and **UBN**'s risk management frameworks, processes, and systems.

These corporate actions will be beneficial in diversifying banks' revenue streams and shielding earnings from the volatile fluctuation in the yield environment.

Recently, the CBN and AMCON announced the sale of Polaris Bank to Strategic Capital Investment Limited (SCIL) for an upfront sum of NGN50bn. Also, SCIL agreed to repay the future value (NGN1.305trn intervention bond over 25 years) of the NGN898bn invested by the CBN in the company. Recall that the CBN created Polaris Bank in 2018 as a bridge bank to rescue the defunct Skye Bank Limited from collapse. **The CBN highlighted that a Divestment Committee was formed to conduct a sale process by private treaty. Thus, we opine that the comprehensive process conducted by the Committee purports that the buyer met the relevant selection criteria. Also, the buyers' expertise and knowledge of the Nigerian banking industry should be an advantage for the bank in the medium to long term.**

Another landmark event in the Nigerian banking sector is the 3-year-old Titan Trust Bank (**TTB**) Limited's 100% acquisition of 105-year-old Union Bank of Nigeria Plc. (**UBN**). **TTB** acquired 89.39% of **UBN**'s shares on December 18, 2021, and subsequently made a mandatory takeover offer (MTO) to the minority shareholders (6.59%) at NGN7.00 per ordinary share. **We anticipate that Titan Trust Bank would synergize its technological strength with UBN's risk management frameworks, processes, and systems to provide a larger platform to meet customers' demands.**

Financial Performance

Banking Sector Earnings Capitalized on Rising Lending Rates

In 9M:2022, the total gross earnings of our coverage banks rose by 25.64% YoY to NGN3.85trn (vs NGN3.06trn in 9M:2021). **WEMABANK** recorded the highest topline increase of 51.17% YoY to NGN93.35bn in the review period. In terms of gross earnings size, **ACCESSCORP** (NGN906.82bn) leads the chart, followed by **ZENITHBANK** (NGN620.57bn) and **UBA** (NGN608.29bn). The improvement in gross earnings reflects the increased interest and non-interest income. For context, there was a general rise in lending rates as average prime and maximum lending rates increased to 12.04% and 27.67% YtD (vs 11.48% and 28.06% in 2021FY) which improved interest income. **Upside factors to earnings are expanding risk asset portfolio (albeit moderately), rising yields, and an increase**

in e-banking transaction volume. Hence, we are optimistic about the sector's earnings growth in 2023FY.

Chart 1: 9M:2022 Gross Earnings of Selected Banks (NGN'bn)

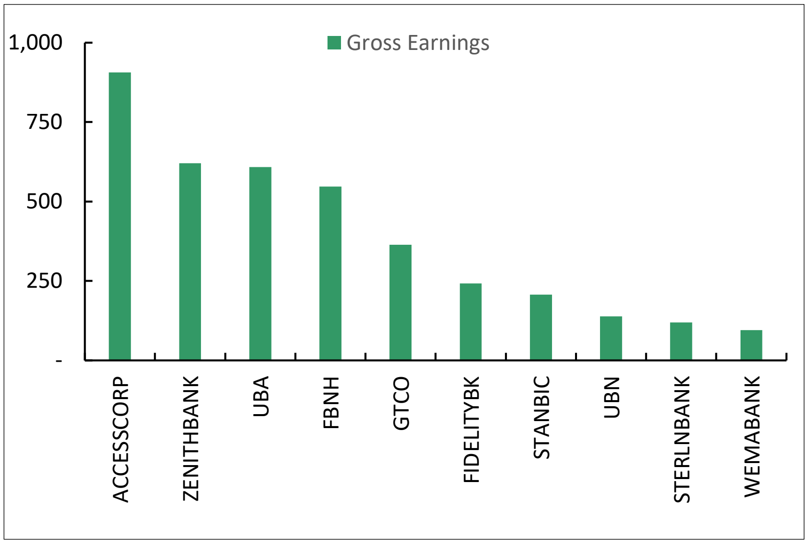
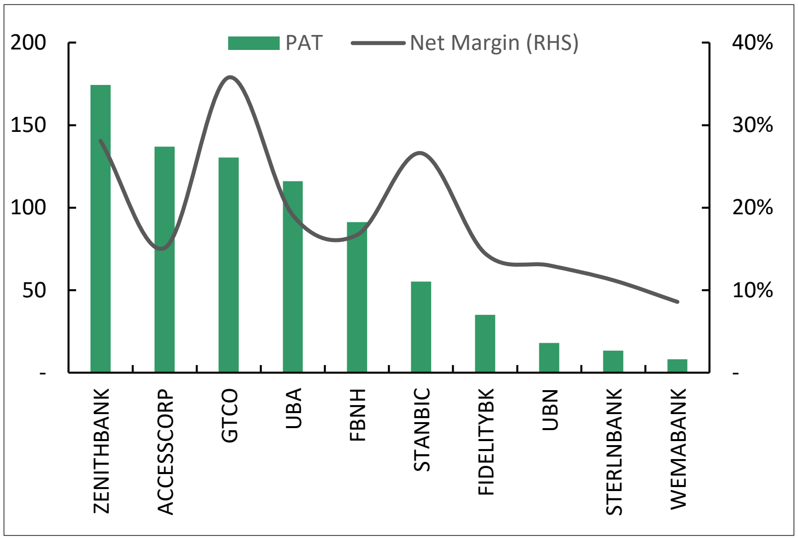


Chart 2: PAT (NGN'bn) and Net Margin of Selected Bank



***Source**: Companies Financials, Meristem Research*

Non-interest income growth continues to support banks' topline growth. More banks reported growth in non-interest income in 9M:2022 over the prior period. **ACCESSCORP** reported the highest annual increase as non-interest income grew by 155.84% YoY. This is attributed to the growth of the company's non-banking service offerings. Results released in 9M:2022 shows that e-banking and trading income contributions were significant to non-interest income growth. However, non-interest revenue fell for **UBN** (-33.22% YoY) and **FIDELITYBK** (-14.62% YoY). **Broadly, we remain optimistic about non-interest income growth for the year as banks continue to seek initiatives to expand their income streams.**

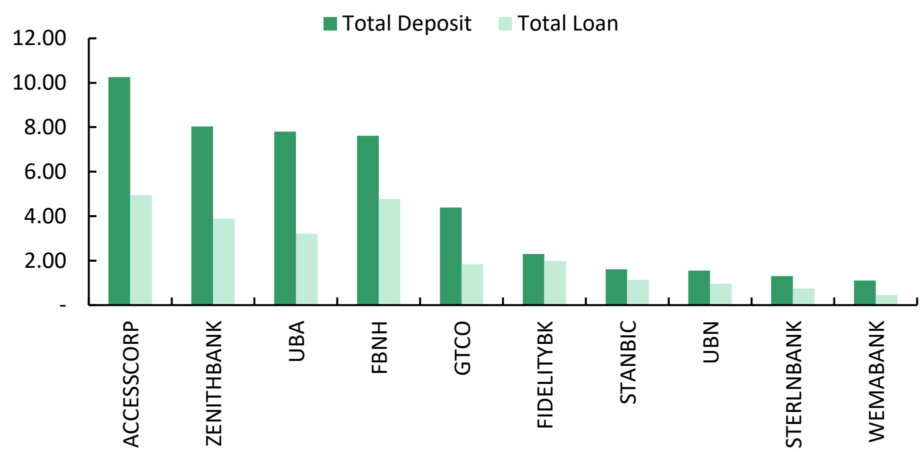
Rising Loan Loss Provision Threatens Profitability

In Q3:2022, we observed a substantial rise in impairment charges in the third quarter financial statement over the comparative quarter in the prior year. Among our coverage banks, there was a 40.88% YoY increase in impairment charges. We attribute this to the heightened risk of credit default, considering the impact of the elevated borrowing cost on customers' capacity to service the loans. Our analysis reveals that **UBA** (299.03% YoY) reported the highest increase to NGN13.59bn in the quarter. However, **ACCESSCORP** recorded the most significant impairment charge of NGN52.95bn.

Customers' Deposits Spur Risk Asset Expansion

The Covered banks increased total assets by 12.46% YtD to NGN62.33trn by 9M:2022, supported by a sizeable increase in customer deposits. Customers' deposits increased 13.95% YtD to NGNG45.98trn. Most of the funding went into loans which grew 14.46% YtD to NGN23.96trn as of 9M:2022. Also, the stock of financial securities grew 3.71% YtD. **The downside to risk asset expansion is the rising borrowing cost. We expect borrowers to reduce their demand for credit due to high borrowing costs.**

Chart 3: **Total Deposits and Loans as at 9M:2022 (NGN'trn)**



Source: *Companies Financials, Meristem Research*

Table 1: Most Recent Financial Metrics (H1:2022)

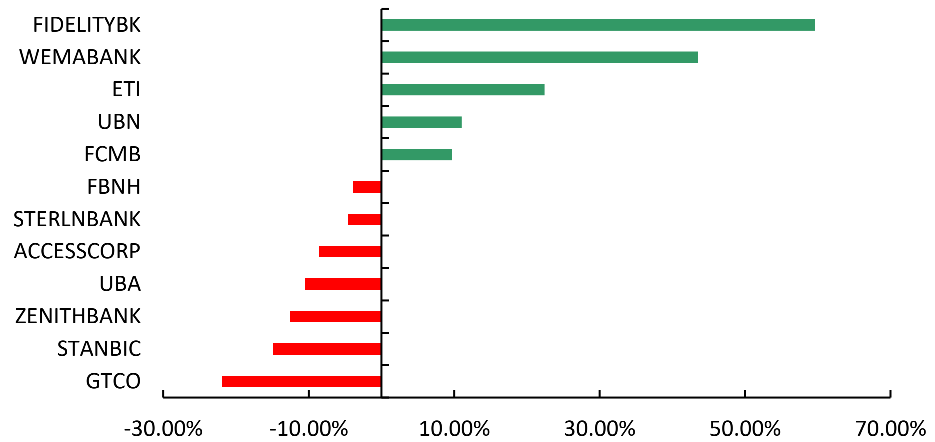
Banks	CAR	LR	CoF	NIM	NPL	CIR
ACCESSCORP	22.61%*	53.00%	3.20%	4.50%	3.70%	65.60%
ETI	14.80%	NA	2.3%~	5.10%	6.20%	56.00%
FBNH**	16.00%	34.50%	2.00%	5.10%	6.00%	67.00%
FCMB	15.10%	30.70%	3.81%~	7.20%	4.60%	68.60%
FIDELITYBK	19.80%	47.00%	4.00%	6.40%	2.70%	69.60%
GTCO	22.02%	38.85%	0.99%	6.51%	6.18%	49.06%
STANBIC	19.70%	112.62%	2.00%	3.50%	2.62%	59.90%
STERLNBANK	14.80%	31.70%*	3.30%*	8.00%*	1.30%	75.70%
UBA	30.3%*	63.70%	2.30%*	5.90%*	3.20%*	63.20%*
UBN	15.30%*	36.00%*	3.90%	3.60%*	4.20%*	76.10%*
WEMABANK	11.60%*	30.00%	4.60%	2.75%	3.46%*	81.70%*
ZENITHBANK	21.00%	60.50%	1.40%	7.10%	4.40%	57.90%

**9M:2022*	*CAR – Capital Adequacy Ratio*	*NIM – Net Interest Margin*
***Q1:2022*	*LR – Liquidity Ratio*	*NPL – Non-Performing Loan*
~2021FY	*CoF – Cost of Funds*	*CIR – Cost to Income Ratio*

Hawkish Policy Stance Spurs Risk-off Sentiments

The Nigerian equities market has had a mixed performance in 2022. The local bourse started the year on a solid footing. However, the switch to a hawkish policy stance by the Monetary Policy Committee (MPC) spurred selloffs in equities as investors took positions in the safe and high-yielding fixed-income assets. The broad negative sentiments led to the **NGXBNK** losing 2.33% YtD. **GTCO** leads the loser chart, having lost 21.54% YtD.

Chart 4: Banking Sector Equities Return (YtD)



***Source**: Bloomberg, Meristem Research*

Furthermore, peer comparison suggests that the **NGXBNK** (PE ratio: 2.51x) is relatively undervalued compared to the South African banking index (PE ratio: 10.58x). **Overall, the low valuation of the sector, combined with the recent upswing of banking tickers, portends a rebound in the prices of stocks in the sector.**

Where Opportunities Lie

Recently, the sentiment towards banking tickers has been broadly positive. However, the plunge in the valuation of some stocks presents the likelihood of capital gains and attractive dividend yield opportunities.

Based on our price targets which has a blend of both fundamentals and market sentiment, we have determined expected ***total return*** *(Upside Potential + 2022FY Expected Dividend Yield)*. The table below contains a ranking of selected companies based on our projected total return.

Table 2: Recommended Stocks

Banks	P/E	YtD	CP	TP	BAC TP	Exp DY	UPP	TR
ETI	2.06x	+22.41%	10.65	14.56	12.02	13.04%	46.00%	59.04%
ZENITHBANK	2.66x	-12.92%	21.90	29.59	33.50	13.08%	39.00%	52.08%
STANBIC	5.02x	-14.86%	30.65	42.45	43.01	7.06%	42.00%	49.06%
UBA	1.96x	-9.32%	7.30	9.15	14.18	14.71%	28.00%	42.71%
ACCESSCORP	1.72x	-7.53%	8.60	10.36	14.20	13.49%	28.00%	41.49%
FCMB	2.14x	+8.70%	3.25	4.35	4.07	5.95%	34.00%	39.95%
GTCO	3.23x	-23.08%	20.00	23.02	36.38	13.49%	18.00%	31.49%

P/E – Price-to-Earnings ratio	*BAC TP – Bloomberg Analyst Consensus Target Price*
YtD – Year-to-Date Return	*Exp DY – Expected Dividend Yield (NGN)*
CP – Current Price (NGN)	*UPP – Upside Potential*
TP – Target Price (NGN)	*TR – Total Returns*

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