06 April 2020

Nigerian Banks

Testing resilience

- **Action/Event:** We stress test the earnings and balance sheet resilience of the banks within our coverage for asset quality deterioration. We look at the impact of a cost of risk of 5% (10% NPL ratio), 10% (20% NPL ratio) and 15% (30% NPL ratio) on earnings and capital adequacy. Our stress test indicates that GTB, Zenith, FBNH and UBA show profitability at a cost of risk of 5%, while only GTB and Zenith show profitability at a cost of risk of 10%. At a cost of risk of 15%, all our coverage names post losses, ranging from negative EPS of N0.74 for GTB and N7.4 for Access. Access's lower efficiency and profitability relative to its large balance sheet increases the risk in our stress test.

- Our coverage shows potential combined loan losses of N670bn (cost of risk of 5%), N1.34tn (cost of risk of 10%) and N2.01tn (cost of risk of 15%). Access and Zenith show the highest potential loan losses, while FCMB and Fidelity show the lowest. This is primarily a function of the balance sheet size of the banks, given our straight-line approach. Ultimately, the level of collateral coverage should limit the overall impairment level.

- **GTB and Zenith's capital levels remain robust in our extreme scenarios:** GTB and Zenith's CAR declines to 19% and 17% in our worst-case scenario, while CAR declines to 8%, 10% and 11% for Fidelity, FCMB and FBNH respectively. This implies capital shortfalls of N53.7bn (UBA), N143.1bn (Access), N122.7bn (FBNH), N60.8bn (FCMB) and N99.2bn (Fidelity).

- **Market pricing the banks close to worst-case scenario, but balance sheet impairments outlook remains difficult:** While the valuations of the banks look attractive at this point, the level of medium- to longer-term impairments on capital remains uncertain at this time. Even with the CBN's forbearance, which allows banks to restructure loans in the oil and gas, manufacturing, agriculture and a few other sectors, the level of weakness of consumer earnings capacity will determine the interest income outlook and potential recovery. Hence, NPL ratio and loan loss impairments may not increase as shown in our stress test, but interest income may collapse considerably as customers request moratoriums to ease earnings pressure from a slowdown in economic activity as a result of COVID-19.

- **Risks:** We see increased asset quality deterioration risk in the oil and gas sector given the volatility in oil prices. We also see high risk in the aviation, tourism, hotel and hospitality segments of the economy as a result of the shutdown. Disruption in the value chain will also affect the general commerce and manufacturing sectors negatively. Further NIR risk from LC commissions and other trade-related income. Lower NII from restructured loans - with adjustments such as moratoriums and lower interest rates depressing interest income. We also see risk to incremental credit growth at this time given a slowdown in economic activity due to the shutdown in major cities in the country. We see upside potential to e-banking revenues and electronic payments for banks in the near to medium term as more customers move from cash to contactless transactions during the shutdown.

- **Top picks:** While the continuous spread of COVID-19 and its impact on the global economy and Nigeria remains a key risk to the market and our banks coverage, **our analysis supports our preference for GTB and Zenith Bank in these turbulent times. Their resilient and robust balance sheets and high efficiency place them in a better position to weather the storm.**

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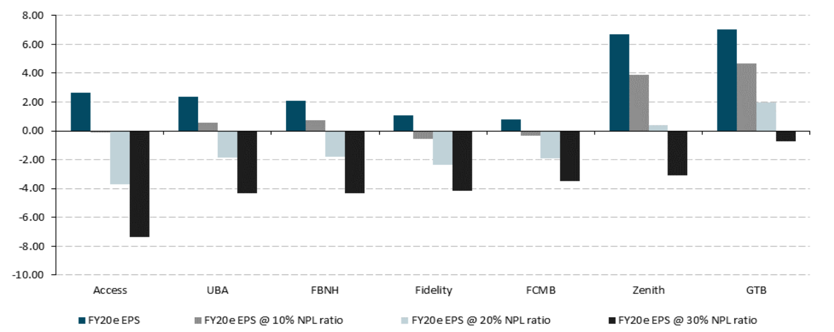
GTB and Zenith show high earnings resilience at 5% and 10% cost of risk

We stress test the earnings and balance sheet resilience of the banks within our coverage for asset quality deterioration. We look at the impact of a cost of risk of 5% (10% NPL ratio), 10% (20% NPL ratio) and 15% (30% NPL ratio) on earnings and capital adequacy. Our stress test indicates GTB, Zenith, FBNH and UBA show profitability at a cost of risk of 5%, while only GTB and Zenith show profitability at a cost of risk of 10%. At a cost of risk of 15%, all our coverage names post losses, ranging from negative EPS of N0.74 for GTB and N7.4 for Access. Access's lower efficiency and profitability relative to its large balance sheet increases the risk in our stress test.

Below, we show caveats and assumptions in our analysis

- We assume 50% coverage on the estimated NPLs, which we see as conservative, given that a reasonable portion of the loan book is secured.
- Hence, we apply a 50% loan loss provision charge straight to P&L.
- We do not differentiate vulnerabilities based on sector and asset risk rating, even though we acknowledge that the higher rated companies are in a better position to absorb the shocks.

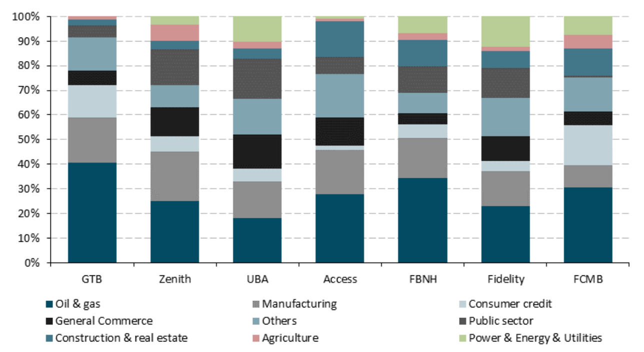
Figure 1: EPS sensitivity to asset quality deterioration and impairments



Source: Company financials, SBGS analysis

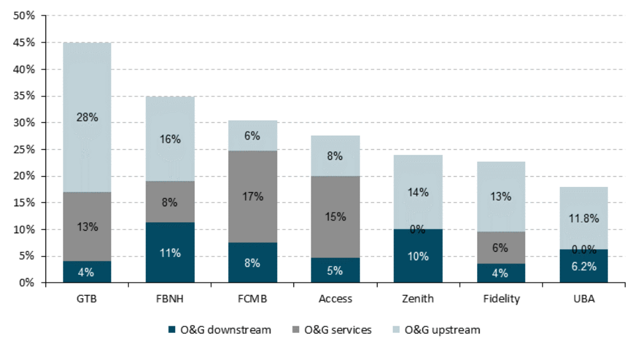
While we apply a simplistic approach in our stress test, we acknowledge that the asset mix and loan mix will make some names more vulnerable than others. Given the material volatility in oil prices, the upstream and midstream/ services oil and gas sectors are more vulnerable to oil price volatility, hence we see higher deterioration risk in GTB relative to peers due to its high upstream and services oil and gas exposure. We also see high risk in FBNH, FCMB and Access.

Figure 2: Gross loan split per sector



Source: Company financials, SBGS analysis

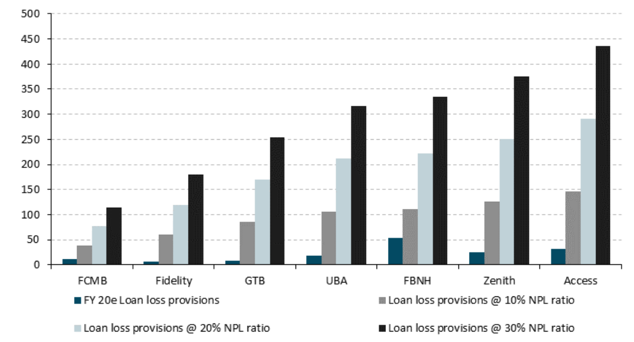
Figure 3: Oil and gas exposure



Source: Company financials, SBGS analysis

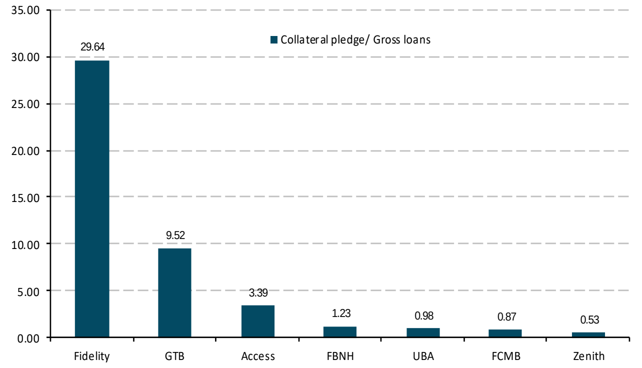
Figures 4 and 5 show the loan loss provision sensitivity to asset quality deterioration, where we show potential combined loan losses of N670bn (cost of risk of 5%), N1.34tn (cost of risk of 10%) and N2.01tn (cost of risk of 15%). Access and Zenith show the highest potential loan losses, while FCMB and Fidelity show the lowest. This is primarily a function of the balance sheet size of the banks, given our straight-line approach. Ultimately, the level of collateral coverage should limit the overall impairment level. Fidelity, GTB, Access and FBNH have pledged collateral multiples of gross loans, while UBA, FCMB and Zenith's pledged collateral does not cover gross loans.

Figure 4: Loan loss provisions sensitivity to asset quality deterioration (N'bn)



Source: Company financials, SBGS analysis

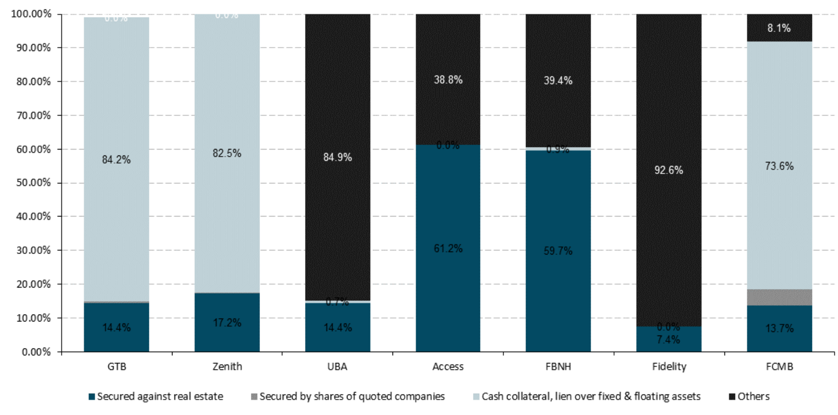
Figure 5: Collateral pledge/gross loans



Source: Company financials, SBGS analysis

In Figure 6 below, we show the latest reported mix of pledged collateral for the banks in our coverage, with the components varying considerably across banks. The others category is collateral such as domiciliation, counter indemnity, asset debenture, lien on shipping documents, and corporate and state government guarantees.

Figure 6: Collateral pledge by type

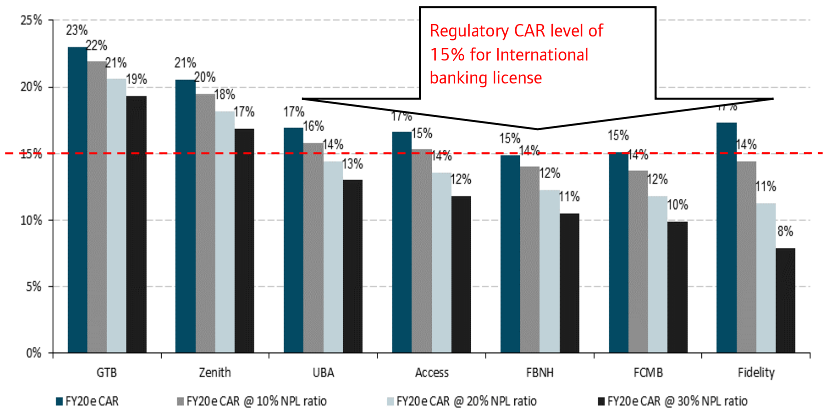


Source: Company financials, SBGS analysis

GTB and Zenith's capital levels remains robust in our extreme scenarios

Our stress test shows the resilience of GTB and Zenith's balance sheets as their capital adequacy ratios remain above the regulatory minimum of 15% for banks with international banking licences. GTB and Zenith's CAR declines to 19% and 17% in our worst-case scenario, while CAR declines to 8%, 10% and 11% for Fidelity, FCMB and FBNH respectively. This implies capital shortfalls of N53.7bn (UBA), N143.1bn (Access), N122.7bn (FBNH), N60.8bn (FCMB) and N99.2bn (Fidelity).

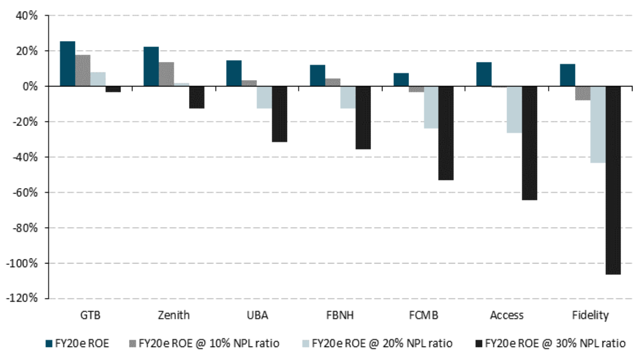
Figure 7: CAR sensitivity to asset quality deterioration and impairments



Source: Company financials, SBGS analysis

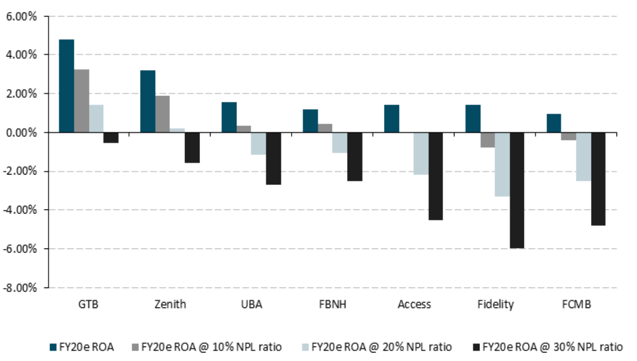
As shown in Figures 8 and 9 below, profitability levels for GTB and Zenith remain resilient above an NPL ratio of 20% and cost of risk of 10%, while our other coverage banks show more vulnerability.

Figure 8: FY20e ROE sensitivity to asset quality deterioration and impairments



Source: Company financials, SBGS analysis and estimates

Figure 9: FY20e ROA sensitivity to asset quality deterioration and impairments

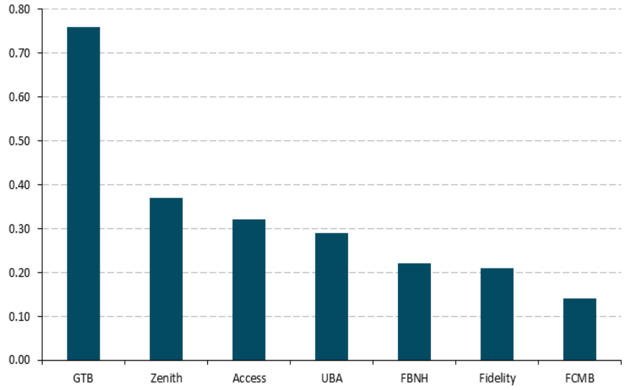


Source: Company financials, SBGS analysis and estimates

Market pricing the banks close to worst-case scenario, but balance sheet impairments outlook remains difficult

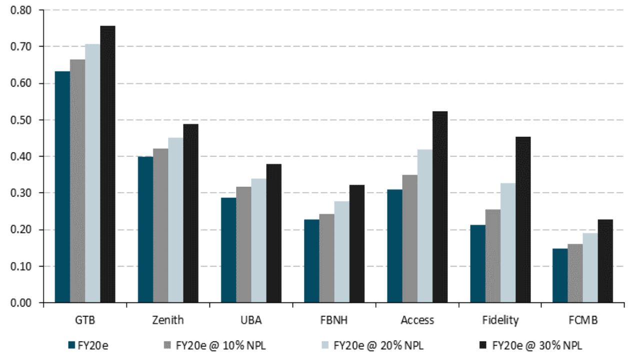
The market appears to be pricing the banks close to our worst-case scenario. While the valuations of the banks look attractive at this point, the level of medium- to longer-term impairments on capital remains uncertain at this time. Even with the CBN's forbearance, which allows banks to restructure loans in the oil and gas, manufacturing, agriculture and a few other sectors, the level of weakness of consumer earnings capacity will determine the interest income outlook and potential recovery. Hence, NPL ratio and loan loss impairments may not increase as shown in our stress test, but interest income may collapse considerably as customers request moratoriums to ease earnings pressure from a slowdown in economic activity as a result of COVID-19.

Figure 10: Trailing P/B valuation for our coverage



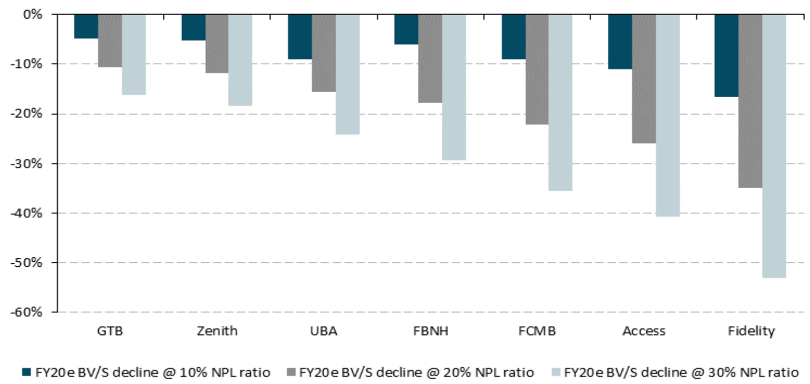
Source: Company financials, SBGS analysis (price based on 2 April 2020)

Figure 11: FY20e P/B (x) sensitivity to asset quality deterioration and impairments



Source: Company financials, SBGS analysis and estimates

Figure 12: FY20e BV/S sensitivity to asset quality deterioration and impairments



Source: Company financials, SBGS analysis and estimates

Risks

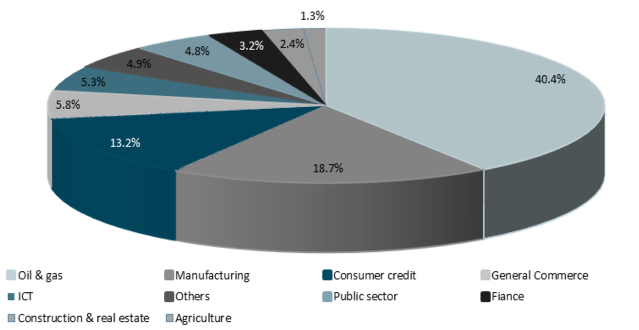
We highlight the following risks in the banking sector from the global impact of COVID-19 and the lockdown of major cities in Nigeria:

- We expect more depreciation pressure from the oil and gas sector given the volatility in oil prices. We also see high risk in the aviation, tourism, hotel and hospitality segments of the economy as a result of the shutdown. Disruption in the value chain will also affect the general commerce and manufacturing sectors negatively.
- Further NIR risk from LC commissions and other trade-related income.
- Lower NII from restructured loans - with adjustments such as moratoriums and lower interest rates depressing interest income.

We see upside potential to e-banking revenues and electronic payments for banks in the near to medium term as more customers move from cash to contactless transactions during the shutdown. This should increase growth and sustainability in the adoption of electronic transactions over the medium to longer term.

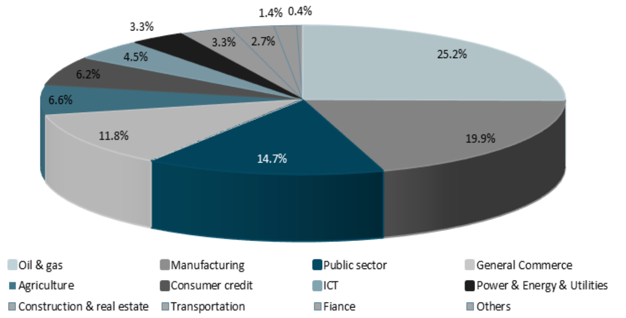
Appendix – loan mix

Figure 13: GT Bank



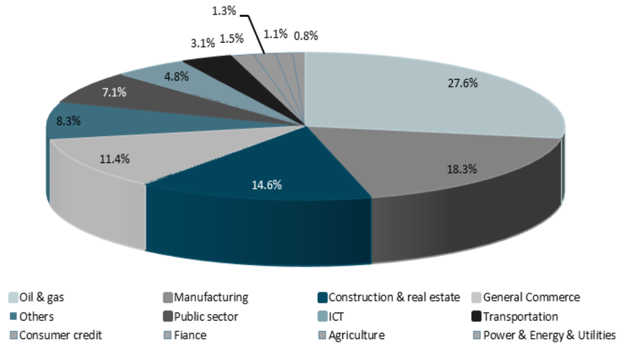
Source: Company financials, SBGS analysis

Figure 14: Zenith Bank



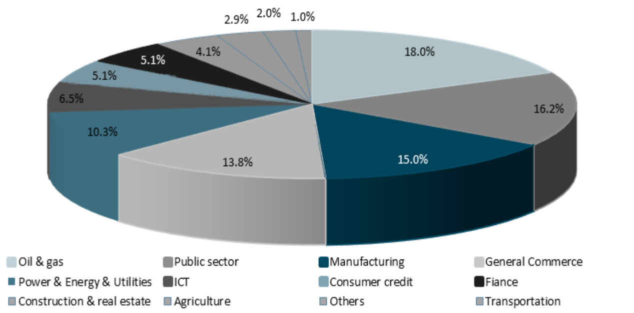
Source: Company financials, SBGS analysis

Figure 15: Access Bank



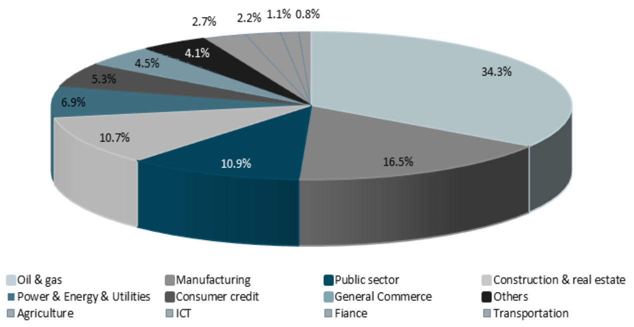
Source: Company financials, SBGS analysis

Figure 16: UBA



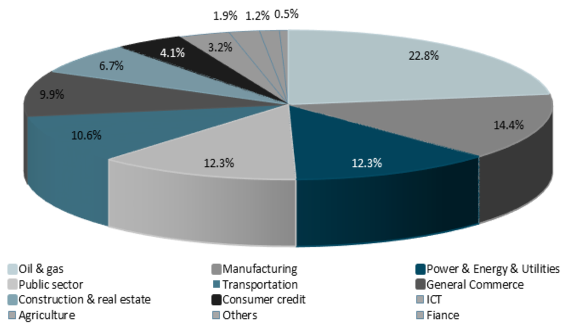
Source: Company financials, SBGS analysis

Figure 17: FBN Holdings



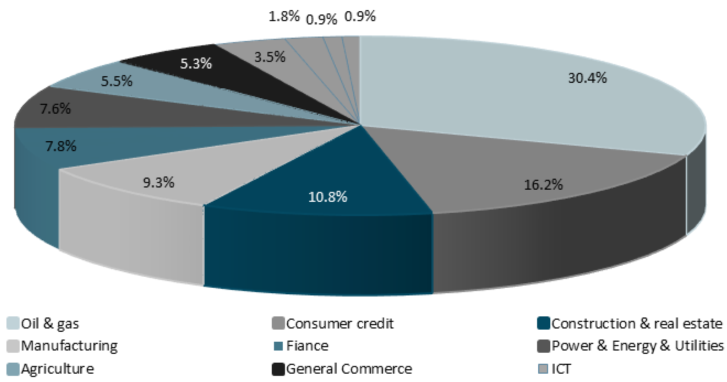
Source: Company financials, SBGS analysis

Figure 18: Fidelity Bank



Source: Company financials, SBGS analysis

Figure 19: FCMB Group



Source: Company financials, SBGS analysis

Companies Mentioned (Price as of 2020/04/03)
Access Bank Plc (ACCESS.LG, N6.05, Spec Buy, TP N11.80)
FBN Holdings Plc (FBNH.LG, N3.95, BUY, TP N12.00)
Fidelity Bank Plc (FIDELIT.LG, N1.69, SBUY, TP N3.00)
First City Monument Bank Plc (FCMB.LG, N1.47, SELL, TP N1.90)
Guaranty Trust Bank Plc (GUARANT.LG, N17.60, BUY, TP N41.00)
United Bank for Africa Plc (UBA) (UBA.LG, N4.95, BUY, TP N12.90)
Zenith Bank Plc (ZENITHB.LG, N11.90, BUY, TP N32.50)

Disclosure Appendix

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Fidelity Bank Plc	D
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Guaranty Trust Bank Plc	D
United Bank for Africa Plc (UBA)	D
Zenith Bank Plc	

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