Nigeria | Equity Research | Banking | Sector Update

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Nigerian Banks: Impact of ongoing monetary reforms and the banking sector

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The banking sector has experienced a material shift in its operating environment since our last publication in January 2024. This shift was due to aggressive policy decisions, which were mostly inspired by efforts to contain the currency crisis and surging inflation, and improve banks' capacity to withstands unexpected changes in key variables. In this report, among other things, we assess potential changes in net earnings and 12-month target prices (TP) of our coverage banks that may be occasioned by the following:

- The new requirement that the NOP limit of the overall foreign currency (FCY) assets and liabilities of banks should not exceed 20.0% short or 0.0% long of shareholders' funds unimpaired by losses
- Discontinuation of daily CRR debits and the adoption of a structured weekly statutory debit on the increases in banks' weekly average adjusted deposits
- Sharp increases in stop rates at auctions and the 400bps increase in monetary policy rate to 22.75%
- The increase in statutory CRR from 32.5% to 45.0%
- The adjustment of the asymmetric corridor to +100bps/-700bps from +100bps/-300bps, previously

We have identified potential implications to banks' earnings in 2024 as follows：

Higher other income on disposal of net-long balances: The new rule on NOP is likely to put an end to the reporting of foreign exchange gains that are the consequence of net-long FX positions across banks. However, banks that are net short are likely to be favoured by an appreciation of the Naira. The impact of this policy is likely to result in a material surge in banks' other incomes in Q1'24, given the 43.1% depreciation of the Naira YtD and its implication for realised gains upon disposal of excess NOP positions.

Asset yields and NIMs: Based on the first and second-order impacts of the rise in auction stop rates and 400bps increase in MPR to 22.75%, we now forecast asset yields to rise by an average of 400 bps across our coverage banks in FY'24 (vs c. 150bps in our previous communication). This adjustment suggests a mean 83.4% increase in interest income for our banking coverage.

Whilst the discontinuation of daily CRR debits is positive, the recent decision of the MPC to raise statutory CRR to 45.0% may appear a downside risk to interest income, with direct inference suggesting that banks can now only deploy 55.0% of new deposits to interest-earning opportunities assuming other rules (such as the loan to deposit ratio) are adhered to.

However, the c.6.0 ppts surge YoY in OMO, NTB, and Bond auction stop rates since the start of the year, combined with the recent 400bps increase in MPR, should more than mask the impact of the 12.5ppts increase in statutory CRR. We, therefore, forecast interest income to strongly rise by an average of 83.5% across our coverage banks in FY'24.

The passthrough of higher interest income to NIMs is likely to be more pronounced for banks with relatively cheaper funding mix and a greater proportion of retail non-high-net-worth individual customers. Across our coverage, GTCO, UBA, ZENITHBANK and FBNH have the lowest funding costs.

Figure 1: Despite having the lowest NIM, ACCESSCORP had the highest interest income in 9M’23

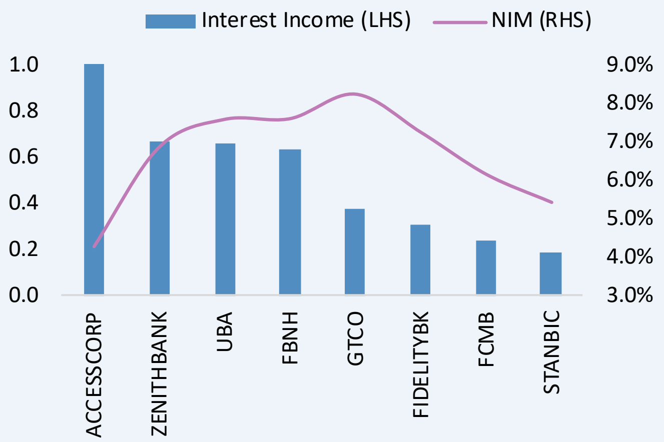
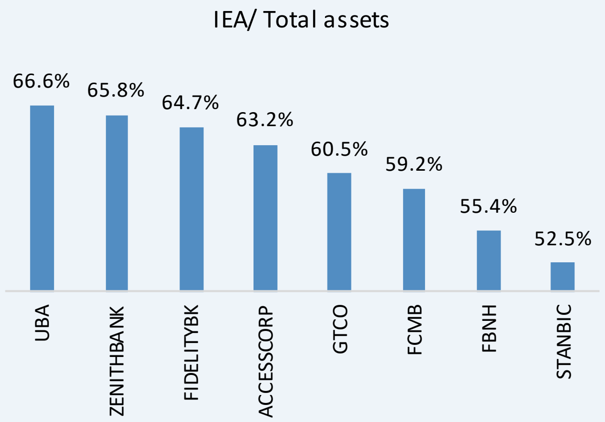


Figure 2: UBA has the highest composition of earning assets



Source: Company Financials, CardinalStone Research; IEA means interest earning assets

NPLs and Capital Adequacy Ratios (CAR): In our view, adverse macroeconomic conditions are likely to increase the risk of NPLs in FY’24 (mean of 3.7% across our coverage), with sectors that are heavily reliant on imported raw materials and equipment maintenances such as manufacturing likely to be badly hit by the short-term cost implications of ongoing reforms. Conversely, dollar-earning sectors such as upstream oil and gas are likely to profit from naira weakness and relatively benign global commodity prices all things been equal. Based on the above, we expect banks to be slightly cautious on loan growth.

The risk to capital adequacy ratios are likely to remain a concern, given the YTD Naira weakness as unfavourable movements of the domestic currency typically bloats the foreign currency segments of risk assets in Naira terms. However, we expect the capitalization of parts of the strong core earnings to provide a notable offset to these concerns.

Valuations and Recommendations: We expect the recent changes in policies to be net-positive for the banking sector over FY’24 – suggesting that current levels are fine-entry opportunities for strategic investors. The sector is also trading at a current PB of 0.6x, which is at material discount to EMEA peer average of 1.1x. In addition to the upside a potential re-rating may engineer, we are of the view that the surging interest rate environment may increase pressure on banks to step up on the dividend front in the coming months. This may open avenues for decent dividend income (vs de-annualized return from fixed income options) in the near term.

Table 1: Key highlights of adjustments on financial estimates

	Previous TP (N)	New TP (N)	Recommendation	Previous FY’24E PAT (N’billion)	New FY’24E PAT (N’billion)	Previous FY’24E ROE	New FY’24E ROE	Implied final dividend yield
ACCESSCORP	36.22	41.23	BUY	365.0	443.3	19.6%	24.3%	11.6%
FBNH	28.42	32.26	BUY	318.7	533.9	20.5%	28.0%	4.0%
FCMB	10.13	12.05	BUY	60.7	128.3	16.3%	30.5%	8.9%
FIDELITYBK	14.17	15.67	BUY	127.6	174.3	27.8%	38.4%	6.3%
GTCO	51.48	53.18	BUY	455.8	546.6	32.6%	38.3%	11.0%
STANBIC	67.69	72.70	BUY	160.2	245.5	30.7%	44.0%	7.9%
UBA	40.55	42.06	BUY	406.9	582.6	18.4%	25.9%	11.1%
ZENITHBANK	51.76	55.37	BUY	502.9	647.6	25.7%	31.9%	11.4%

Source: Company Financials, CardinalStone Research

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