

Sterling Bank Plc. | Earnings Report

9 months ended 30th September, 2016

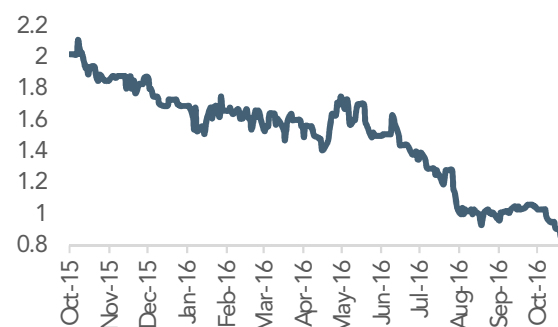
Stronger asset yields provide fleeting respite
(SELL: ₦0.78)

- Sterling Bank Plc. (Sterling) released unaudited 9M 2016 results, wherein gross earnings dipped 2.6% YoY to ₦79.6 billion. Correspondingly, PBT and PAT contracted 26.9% and 26.6% YoY to ₦6 billion and ₦5.5 billion respectively which are largely in line with our estimates. Though asset quality concerns remained an issue, with annualized cost of risk at a three-quarter high of 2.9%, stronger asset yields—a fallout of monetary policy tightening—helped cushion the impact of asset quality concerns over Q3 16. That said, following weaker H1 16, the Q3 16 does little to change the overall picture as 9M 16, if annualized, places Sterling on track for a weaker FY 16 reading.

Rebound in interest income offsets NIR slack

- Following the 200bps hike in MPR in July and the resulting expansion in the naira yield curve over Q3 16, Sterling reported a 27% QoQ rise in interest income to ₦27.3 billion as upward repricing on loans and higher income from investment securities drove asset yields 360bps higher QoQ. Over the quarter, net loans expanded 7% QoQ and the bank linked this to translation impact of currency weakness on size of FCY loans. (40%). Nonetheless, the tight liquidity conditions drove funding cost pressure with Sterling reporting a 58% QoQ rise in interest expense to ₦11.4 billion.

Income Statement Data			
	2016 – 9M'm	2015 – 9M'm	%chg
Gross Earnings	79,652	81,812	-2.64%
PBT	6,071	8,304	-26.89%
Tax	-534	-757	-29.37%
PAT	5,537	7,548	-26.64%
Balance Sheet Data			
	2016-Sep 'm	2015 -Dec 'm	%chg
Cash	110,514	115,924	-4.67%
Loans	495,284	338,726	46.22%
Deposits	595,085	590,889	0.71%
Fixed Asset	15,107	15,258	-0.99%
Net Assets	153,228	95,566	60.34%
Stock Data			
Price	₦0.84		
52-week range	₦0.81 - ₦2.02		
Market Cap. (N'm)	₦24,183		
1-month Avg. Vol	8,570,582		
Curr. PE	2.92X		
Bloomberg Ticker	STERLNBA.NL		
Sterling Bank Plc- Share Price Trend			


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- Parsing through other breakdowns, while deposit mix improved (CASA: +6pps to 69%), Sterling resorted to more expensive interbank (+74% QoQ) and other borrowings (375% QoQ) over the period. Consequently, annualized WACF for Q3 16 rose 2.7pps QoQ to 6.8% (9M 16: 5.3%). Nonetheless, monetary policy tightening was net positive for Sterling with net interest income and NIM expanding 15.5% QoQ and 120bps respectively.
- However, as in Q2 16, NIR contracted 27% QoQ to a 12-quarter low of ₦2.2 billion following a loss in trading (₦341 million) declines in other operating income.

Tight lid on costs drives improvement in CIR

- Q3 16 opex declined 4% QoQ to ₦12.9billion largely due to a cutback in other operating expenses (-37% QoQ). The rise in CIR witnessed in the last two quarters came to a halt with a 680bps contraction to 71.2%, with declines in opex suggesting improved operational efficiency.

Deterioration in macro drives uptick in impairment charges

- In line with continued deterioration in economic landscape, Sterling reported 59% QoQ rise in impairment charges to a 6-quarter peak of N3.5 billion. Breakdowns reveal a 26% QoQ jump in specific impairments, implying fresh asset quality concerns over the period. In our view, Sterling's significant exposure to sectors currently in recession such as Oil and Gas (18%) and real estate (12%) leave the bank susceptible to deterioration in loan quality. The impairment charges translate to annualized cost of risk of 2.9% (9M 16: 1.9%).
- Overall, strong interest income and better control on costs helped drive 7% QoQ improvement in PBT while PAT rose a milder 3% QoQ due to higher effective taxes (+420bps QoQ to 10.3%).

Weaker asset quality and NIR to weigh on earnings

- Going into Q4 16, we see limited prospects for significant down leg in the naira from current levels and forecast net loans to close FY 16 at ₦510 billion (9M 16: ₦495 billion). Nonetheless, higher asset yields should, as in Q3 16, support expansion in interest income which we forecast at ₦28 billion (+3% QoQ). This brings FY 16 interest income to ₦110 billion. On the funding side, we expect the tight liquidity conditions and Sterling's resort to expensive interbank lending over Q3 16 – suggestive of funding cost pressures— to remain intact over Q4 16 and forecast interest expense of ₦13.8 billion for the quarter with 2016E at ₦41 billion. Given NIR contraction over 9M 16, we forecast Q4 16E of ₦2.9 billion in line with the annualized run rate which yields FY 16E NIR at ₦13.8 billion.
 - On asset quality, Sterling's sizable exposure to sectors facing headwinds: upstream O&G (H1 16: 18% loan book) and real estate (H1 16: 12% of loans) stoke concerns on asset quality. Thus, we forecast annualized cost of risk to close FY 16 higher at 2.3% which translates to impairment charge of ₦11 billion (+44% YoY). Net impact of our model adjustments result in Q4 16E PBT and PAT of ₦7.7 billion (-30% YoY) and ₦7 billion (-32% YoY) respectively.
 - Overall, largely reflecting the asset quality issues and NIR contraction over 2016, we forecast FY 16E EPS of ₦0.24 (-32% YoY) and FVE of **₦0.78** for Sterling. On dividends, we see the contraction in Sterling's CAR (YTD: -680bps to 10.7%) over 9M 16 as leaving that bank with scant buffer over regulatory 10% thresholds for its license class. Though the bank raised ₦35 billion in Tier II capital in H2 16, we think the low capital levels constrain loan growth outlook and limit scope for dividend payments in 2016.
 - Sterling currently trades at 2.9x (P/E) and 0.2x (P/B) which are at respective discounts to Bloomberg Nigerian banking sector averages of 4.9x and 0.4x. Given the depressed earnings outlook and sizable downside implied in our FVE relative to last trading price of ₦0.84, we place a **SELL** rating on the stock.
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Summary of Results and Forecasts - Naira (₦)

QUARTERLY					
Income Statement (₦'000)*					
	Q1 2016A	Q2 2016A	Q3 2016A	Q4 2016E	
Gross earnings	25,505	24,550	29,597	31,046	
Interest Income	20,053	21,488	27,352	28,052	
Interest Expense	(8,639)	(7,271)	(11,465)	(13,669)	
Net interest income	11,414	14,216	15,888	14,383	
Non-Interest Revenue	5,451	3,063	2,245	2,995	
OPEX	(12,619)	(13,481)	(12,908)	(11,154)	
Provisions	(1,440)	(2,224)	(3,534)	(4,542)	
PBT	2,807	1,574	1,690	1,682	
Tax	(264)	(96)	(174)	(241)	
PAT	2,543	1,478	1,516	1,442	
ANNUAL					
Income Statement (₦'000)*					
	FY 2014A	FY 2015A	FY 2016F	FY 2017F	FY 2018F
Gross earnings	103,679	110,194	110,698	109,162	116,173
Interest Income	77,932	80,909	96,945	92,394	97,219
Interest Expense	(34,915)	(41,367)	(41,043)	(40,944)	(45,556)
Net interest income	43,017	39,542	55,902	51,451	51,663
Non-Interest Revenue	25,747	29,285	13,754	16,768	18,954
OPEX	(50,627)	(49,659)	(50,161)	(50,202)	(51,285)
Provisions	(7,389)	(8,151)	(11,740)	(9,236)	(6,906)
PBT	10,748	11,016	7,754	8,781	12,426
Tax	(1,743)	(724)	(775)	(1,054)	(1,491)
PAT	9,005	10,293	6,978	7,727	10,935
Balance Sheet (₦ '000)*					
Assets					
Cash & Short term funds	320,841	254,061	115,924	121,720	127,806
Net Loans	371,246	338,726	510,444	513,102	531,234
Fixed Assets	13,952	15,258	16,555	18,045	19,759
Total Assets	824,539	799,451	866,394	929,280	1,000,176
Liabilities					
Deposits	655,944	590,889	597,966	649,807	707,395
Borrowings	49,935	64,849	97,274	102,138	107,245
Total liabilities	739,824	703,886	779,278	835,982	898,677
Shareholders' fund	84,715	95,566	87,116	93,297	101,499
Key Ratios					
EPS	0.31	0.36	0.24	0.27	0.38
DPS	0.06	0.09	-	0.05	0.09
BVPS	2.94	3.32	3.03	3.24	3.53
P/B	0.29	0.26	0.28	0.27	0.24
ROE	12.2%	11.4%	7.6%	8.6%	11.2%
ROA	1.2%	1.3%	0.8%	0.9%	1.1%
Asset yields	14.1%	12.8%	13.8%	12.0%	12.3%
WACF	5.3%	6.1%	6.1%	5.7%	5.8%
NIM	7.8%	6.3%	7.9%	6.7%	6.5%
Cost of risk	2.0%	2.4%	2.3%	1.8%	1.3%
NPL ratio	3.1%	4.8%	4.0%	3.5%	3.0%
Loans/Deposit	56.4%	56.6%	57.3%	85.4%	79.0%
Cost to income	73.6%	72.2%	72.0%	73.6%	72.6%

Source: ARM Research *unless otherwise stated

ARM ratings and recommendations

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6 month period (minimum) to the review date. We adopt a 5 point rating system for this category of stocks and a 3 point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
STRONG BUY	>20%	BUY	>20%
OVERWEIGHT	10% — 20 %	NEUTRAL	5% — 20 %
NEUTRAL	0% — 10 %	SELL	<5%
UNDERWEIGHT	-5% — 0%		
SELL	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject to reasonable portfolio constraints
UNDERWEIGHT	Minimise exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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