MOODY'S
INVESTORS SERVICE

CREDIT OPINION
16 November 2017

Update

Rate this Research

**RATINGS**

**Sterling Bank Plc**

| | |
|---|---|
| Domicile | Lagos, Nigeria |
| Long Term Debt | Not Assigned |
| Long Term Deposit | B3 |
| Type | LT Bank Deposits - Fgn Curr |
| Outlook | Stable |

*Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*


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# Sterling Bank Plc

## Update following rating action

## Summary


On 10 November 2017, we affirmed Sterling Bank Plc's (Sterling) baseline credit assessment (BCA) at b3, issuer local currency deposit ratings at B2/Not Prime and local currency national scale rating (NSR) at A2.ng/NG-1. Concurrently, we downgraded the bank's long-term foreign currency foreign currency deposit rating to B3 from B2, foreign currency NSR to A3.ng/NG-2 from A2.ng/NG-1 and long-term counterparty risk assessment to B2(cr)/NP(cr). The decision to downgrade the foreign currency deposit and NSRs follows the downgrade of the relevant country ceiling, while the downgrade of the CR Assessment reflect the government's weakened capacity to provide support, as reflected in the downgrade of the sovereign issuer rating to B2 from B1 on 7 November 2017.

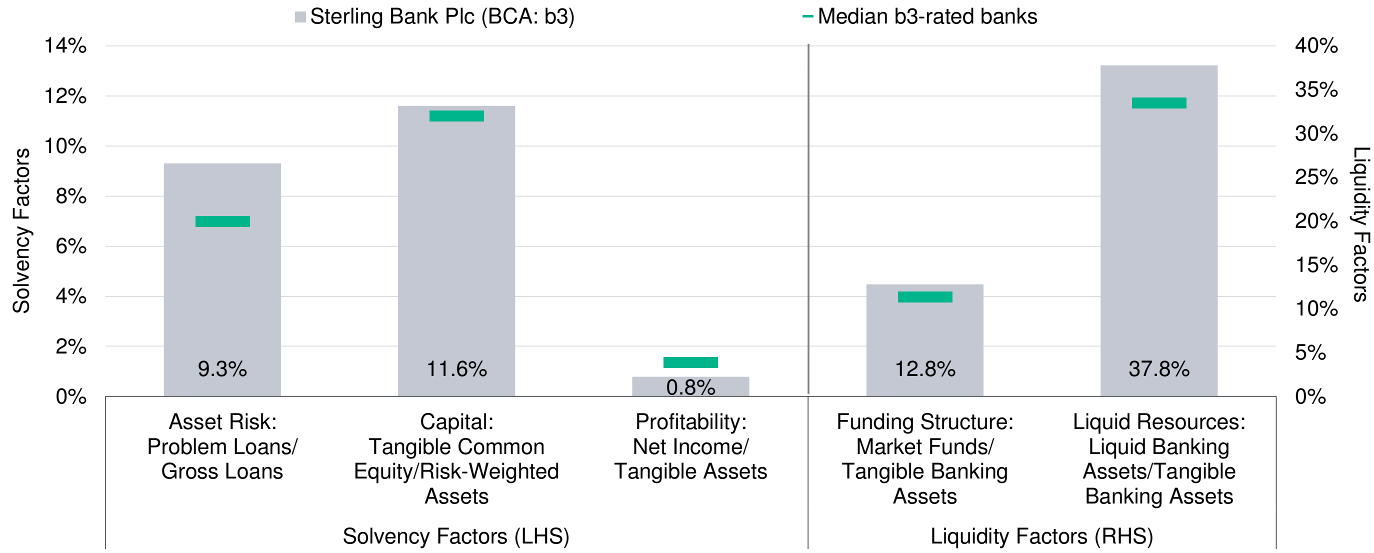
Sterling's b3 BCA reflects (1) a resilient deposit funded balance sheet and stable local currency liquidity balanced against (2) Nigeria's still challenging operating environment (3) low foreign currency liquidity buffers; (4) vulnerabilities in asset quality on account of high single-name and sector concentration risks; and (5) modest capital levels, especially in light of the bank's high oil and gas and foreign currency loans exposure.

Sterling's B2 local currency deposit rating benefit from one notch uplift because we believe that the bank will benefit from government support in the event of need. We assess the likelihood of support from government as 'high'.

Exhibit 1

**Rating Scorecard**

**Key Financial Ratios**




Note: These represent our Bank methodology scorecard ratios, whereby asset risk and profitability reflect the weaker of either the latest reported or average of last three year-end and latest reported ratios. Capital is the latest reported figure. Funding structure and liquid resources ratios reflect the latest year-end figures.
Fully-adjusted ratios. Here our market funding ratio excludes deposits from other financial institutions.
*Source: Moody's Investors Service*

## Credit strengths

» A resilient deposit funded balance sheet and solid local currency liquidity buffers

» Improvements to the bank's IT infrastructure and risk management processes and a growing retail product suite

## Credit challenges

» Nigeria's `Very Weak +' Macro Profile

» Elevated asset risks compounded by higher concentration risks

» Low foreign currency liquidity, although improving

» Moderate capitalization levels and low provisioning coverage

## Rating outlook

All the long-term ratings assigned to Sterling carry a stable outlook, reflecting our expectation that the bank's asset quality and profitability metrics which have deteriorated recently will likely stabilise over the next 12-18 months.

## Factors that could lead to an upgrade

» There is limited pressure for an upgrade of the bank's ratings in the short term given the wider macroeconomic challenges and their impact on the banking system as a whole. However, upward pressure on the rating could develop if there are material improvements in the bank's capital, foreign currency liquidity and profitability metrics.

## Factors that could lead to a downgrade

» The ratings could be downgraded if we witness a deterioration in the bank's asset quality and/or capital generation capacity beyond what is already assumed in the ratings. The ratings could also be downgraded in the event of a downgrade of the sovereign and/or if we assess that the government's willingness to provide support in the future will decline below our current assumption of 'high'.

## Key indicators

Exhibit 2

**Sterling Bank Plc (Consolidated Financials) [1]**

| | 6-17[2] | 12-16[2] | 12-15[2] | 12-14[2] | 12-13[3] | CAGR/Avg.[4] |
|---|---|---|---|---|---|---|
| Total Assets (NGN million) | 957,861 | 834,190 | 799,451 | 824,539 | 707,797 | 9.0[5] |
| Total Assets (USD million) | 3,043 | 2,648 | 4,016 | 4,506 | 4,425 | -10.1[5] |
| Tangible Common Equity (NGN million) | 98,867 | 94,947 | 93,412 | 85,026 | 62,417 | 14.0[5] |
| Tangible Common Equity (USD million) | 314 | 301 | 469 | 465 | 390 | -6.0[5] |
| Problem Loans / Gross Loans (%) | - | 9.3 | 4.6 | 2.7 | 1.8 | 4.6[6] |
| Tangible Common Equity / Risk Weighted Assets (%) | - | 11.6 | 13.7 | 11.8 | 10.2 | 12.4[7] |
| Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%) | - | 42.8 | 14.9 | 10.7 | 8.6 | 19.2[6] |
| Net Interest Margin (%) | 6.3 | 6.7 | 5.0 | 5.8 | 5.7 | 5.9[6] |
| PPI / Average RWA (%) | - | 2.3 | 2.6 | 2.3 | 2.9 | 2.4[7] |
| Net Income / Tangible Assets (%) | 0.8 | 0.6 | 1.3 | 1.1 | 1.2 | 1.0[6] |
| Cost / Income Ratio (%) | 81.0 | 74.6 | 73.0 | 75.2 | 71.1 | 75.0[6] |
| Market Funds / Tangible Banking Assets (%) | 19.7 | 12.8 | 7.6 | 5.5 | 5.5 | 10.2[6] |
| Liquid Banking Assets / Tangible Banking Assets (%) | 39.0 | 37.8 | 52.2 | 49.7 | 49.1 | 45.6[6] |
| Gross Loans / Due to Customers (%) | 88.1 | 81.5 | 60.0 | 58.1 | 57.6 | 69.1[6] |

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Basel I; IFRS [4] May include rounding differences due to scale of reported amounts [5] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [6] Simple average of periods presented for the latest accounting regime. [7] Simple average of Basel II periods presented

*Source: Moody's Financial Metrics*

## Profile

Sterling Bank Plc (Sterling Bank) is a full-service Nigerian commercial bank based in Lagos. It provides commercial, retail and corporate banking services to individuals, businesses, institutions, the government and non-profit organisations. As of 31 December 2016, it held a market share of approximately 2.9% in terms of total assets.

As of 30 June 2017, Sterling Bank distributed its products and services through a network of 180 business offices and 776 ATMs. It reported total consolidated assets of NGN957.9 billion (USD3.0 billion).

Sterling Bank was established in 1960 as a private liability company, NAL Bank Plc (NAL). As part of consolidation reforms introduced in 2004 by the Central Bank of Nigeria (CBN), NAL merged with Indo-Nigeria Merchant Bank (INMB), Magnum Trust Bank, NBM Bank Limited and Trust Bank of Africa Limited in 2006 to form Sterling Bank Plc. Since 1993, Sterling Bank's shares have been listed on the Nigerian Stock Exchange (ticker: STERLNBANK). As of 30 June 2017, the bank's largest shareholder was Silverlake Investment Limited, which owned 25.0% of its total share capital.

For further information on the bank's profile see Sterling Bank Plc Company Overview

## Detailed credit considerations

### Nigeria's macro profile: `Very Weak +'

Our methodology comprises an assessment of a bank's operating environment which, for Sterling, is based on our assessment of Nigeria's macro profile, where the bank conducts all of its business. Nigeria's macro profile score is `Very Weak +', which reflects the country's fiscal dependence on the oil and gas sector, its weak institutions and relatively high level of corruption (based on indices from the World Bank).

We acknowledge the Nigerian banking sector features significant growth opportunities given low banking penetration, especially in retail and SME space. However, high loan growth in recent years, a large proportion of which was foreign currency denominated, and high loan book concentrations tend to keep credit risks high.

### Asset quality metrics improved in the first half of 2017 but we expect assets risks to remain high

An important factor driving Moody's view of Sterling's standalone assessment is the bank's asset quality metrics, which are negatively pressured by Nigeria's challenging operating environment. The bank's reported NPL ratio declined to 7.4% as of June 2017 from 9.3% as of end of 2016 and is superior to the system's average NPLs.

However, we acknowledge that over a full economic cycle, Sterling's loan book is more likely to witness greater asset quality volatility than other large domestic commercial banks. This is because Sterling's strategy is predominantly centered around servicing the value chain of Nigerian corporates, with the majority of these corporates tending to be smaller in size than those serviced by the larger domestic banks. As a result, these borrowers tend to have limited balance sheet and cash flow flexibility, driving the fluctuations in Sterling's asset quality (the bank's NPL ratio was 7.4% as of June 2017, 9.3% in 2016 and 4.6% in 2015).

Although Sterling's foreign currency denominated loan book, at 39.3% of total loans, is below the system's average of above 45%, it remains sizeable, leaving the bank exposed to the exchange rate volatility of the naira. The foreign currency loan book is dominated by the struggling oil and gas and power sectors, with these two sectors contributing a combined 76% of foreign currency loans.

The bank's exposure to the oil and gas industry (43.4% of total loans as of H1 2017) is higher than the system's average of about 30%, leaving the bank exposed to oil price volatility. The oil and gas sector contributed 53.5% of the bank's NPLs in 2016 and though we expect global oil prices to stabilise over the next 12 to 18 months we still see negative asset quality pressure coming from this sector. We note that many of these oil and gas loans have been restructured via maturity extensions, however, given that global oil prices are still considerably lower than their 2014 levels, the sector remains under pressure.

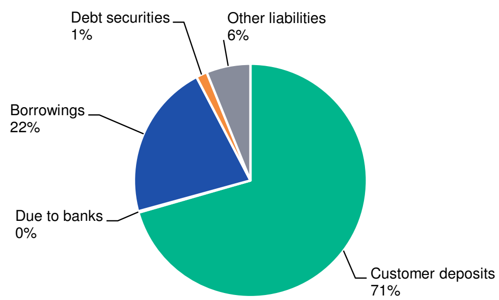
Like many similarly rated banks, Sterling's loan portfolio is concentrated; single name concentration risk is indicated by the exposure to the bank's top 20 borrowers, which is larger than the bank's tangible capital, exposing it to potential erosions of capital in case one or more of the large obligors default. The bank's oil and gas loan exposure is also larger than the bank's tangible common equity, exposing capital to significant erosions should one or more of the oil and gas companies default.

We recognise Sterling's investments and improvements in its IT infrastructure, risk management processes and procedures, and overall governance. As such, we would expect that any future volatility in asset quality would likely be significantly lower than in the past. Sterling's NPLs peaked during the financial crisis of 2009 at a reported ratio of 24%.

### Resilient deposit base moderated by rising market funds

Sterling is predominantly deposit funded with moderate reliance on more sensitive market funds. As of June 2017, deposits contributed 71% of the bank's total liabilities, (see Exhibit 3) which is in line with other major banks. However, the majority of Sterling's deposits are not from individuals but more volatile corporate deposits.

Exhibit 3
**Sterling's funding is dominated by customer deposits**
**Liability structure as of June 2017**




*Source: Company reports*

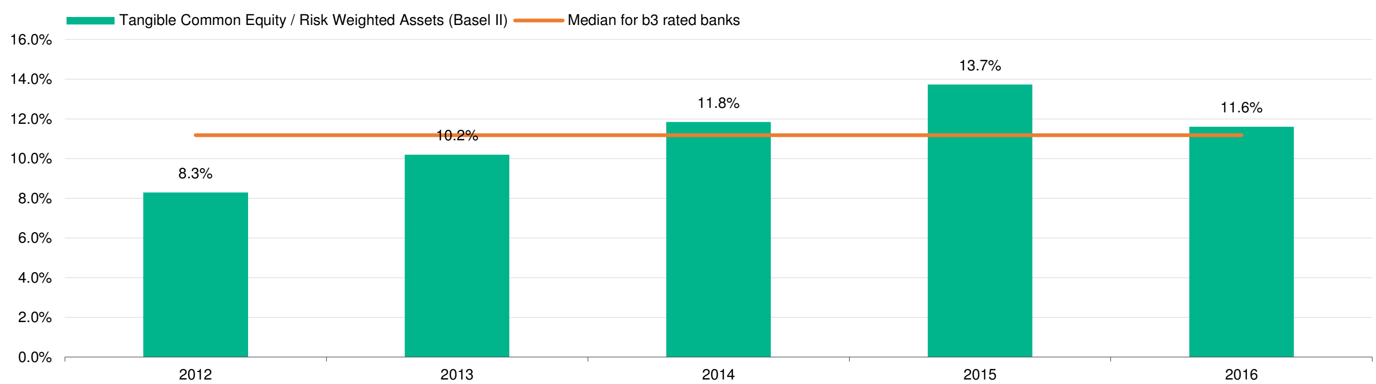
Sterling's liquidity buffers decreased in 2016, alongside other Nigerian banks, as it had to transfer funds to the central bank under the Treasury Single Account (TSA) initiative (which requires federal government agencies to keep their excess deposits in a single account maintained with the Central Bank of Nigeria). Subsequently, foreign currency deposits declined by 37% in 2016 resulting in a high foreign currency loan to deposit ratio of 103%. However, liquidity pressures have diminished in the first half this year and the bank's liquid banking assets as a proportion of tangible banking assets increased to 39.0% as of June 2017 from 37.8% in 2016. That said, Sterling's market funds to tangible banking assets ratio rose to 19.7% in H1 2017 from 12.8% in 2016, indicating growing reliance on confidence-sensitive non-deposit funding.

We expect Nigeria's banking system foreign currency liquidity to remain tight over the near-term but pressure to reduce over the next 12 months. Foreign currency withdrawals are abating and management expects dollar deposit growth to recover this year.

### Relatively weaker efficiency will pressure profitability and organic capital growth

Sterling's tangible common equity (TCE) to risk-weighted assets (RWAs) (Basel II) deteriorated to 11.6% in December 2016 from 13.7% as of December 2015 (Exhibit 4), because of an increase in Moody's adjusted risk weighted assets to N817.5 billion from N680.5 billion (on account of naira devaluation) and lower retained earnings due to lower profitability.

Exhibit 4
**Sterling's improving capitalisation declined in 2016 but still compares favourably against global peers**
**Tangible Common Equity/Risk Weighted Assets**




2012 and 2013 are Basel I ratios; 2014 - 2016 are Basel II ratios
*Source: Moody's Investors Service*

Sterling's relatively low profitability reduces the bank's ability to generate capital organically. Given the relatively small size of the bank within the system, Sterling's cost of deposits tend to be higher than that of its peers. During H1 2017, pressure on fee and commission income due to a dearth of new loans and transactions resulted in non-interest income falling by 16.9%, suppressing the bank's operating income which declined by 0.2%. Consequently, as of H1 2017, the bank's cost to income ratio was high at 81.1% and net income to tangible assets was only 0.8%; both ratios being inferior to similarly rated banks globally. Sterling's relatively weak efficiency ratio and low return on assets are partly explained by its recent investments in branch expansion, digital platforms and various retail products and we expect some improvements in the metrics as the bank gains scale from these investments.

Sterling's reported capitalization is moderated by the bank's exposure to both foreign currency loans and the government of Nigeria; primarily through its holdings of government securities - which are risk-weighted at zero under the domestic regulatory framework. In order to more fully capture the risks associated with government bonds, our practice globally is to assign a risk-weight to sovereign debt holdings, as per guidance of the Basel Committee. For a sovereign rated B2, stable, like Nigeria, we assign a 100% risk-weighting.

Our scenario analysis shows that the bank can adequately absorb losses under our base case, although capital is vulnerable to credit losses under a more severe scenario.

## Sources of facts and figures in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the central bank. Bank specific figures originate from banks' reports and Moody's Banking Financial Metrics. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document: "Financial Statement Adjustments in the Analysis of Financial Institutions" published on 13 June 2017.

## Support and structural considerations

### Government support

The B2, stable local currency deposit rating incorporate one notch of rating uplift from its b3 BCA, based on Moody's assessment of a `High' probability of support in case of financial stress. A strong willingness to support the banks by the Nigerian government was demonstrated in the last crisis, when banks were rescued through recapitalisations and balance sheet clean ups via outright purchases of NPLs by the Asset Management Corporation of Nigeria (AMCON). Furthermore, Nigerian regulatory authorities do not currently have bail-in powers that would allow them to impose losses on creditors outside of a liquidation process.

### CR Assessment

We assign a Counterparty Risk Assessment of B2(cr) /Not Prime(cr) to Sterling Bank. The CR Assessment is one notch higher than the BCA of b3 as we believe senior obligations represented by the CR Assessment will likely be preserved in order to limit contagion, minimize losses and avoid disruption of critical functions.

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default; and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

### National scale rating

Sterling's national scale ratings of A2.ng/NG-1 for local currency deposits and A3.ng/NG-2 for foreign currency deposits are generated from the bank's global scale ratings through maps specific to each country. NSRs are not intended to rank credits across multiple countries; instead they provide a measure of relative creditworthiness within a single country (Nigeria in the case of Sterling). Moody's NSRs are given a two-letter suffix to distinguish them from the agency's Global Scale Ratings. For example, NSRs in Nigeria have the country abbreviation "ng".

Sterling's national scale ratings capture the bank's predominantly deposit funded base and improvements in the bank's IT infrastructure and risk management processes. These strengths are balanced against low foreign currency liquidity buffers, which underpin the lower national scale foreign currency deposit rating compared with its local currency deposit national scale rating; vulnerabilities in asset quality on account of high single-name and sector concentration risks (e.g. oil and gas loans are 43% of gross loans); and relatively modest capital levels, especially versus the bank's high foreign currency loans exposure (39% of gross loans).

### About Moody's bank scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

## Rating methodology and scorecard factors

Exhibit 5

**Sterling Bank Plc**

| **Macro Factors** | | |
|---|---|---|
| **Weighted Macro Profile** | **Very Weak +** | **100%** |

| **Factor** | **Historic Ratio** | **Macro Adjusted Score** | **Credit Trend** | **Assigned Score** | **Key driver #1** | **Key driver #2** |
|---|---|---|---|---|---|---|
| Solvency | | | | | | |
| Asset Risk | | | | | | |
| Problem Loans / Gross Loans | 9.3% | caa2 | ↓ | caa1 | Loan growth | |
| Capital | | | | | | |
| TCE / RWA | 11.6% | b3 | ↓ | b3 | | |
| Profitability | | | | | | |
| Net Income / Tangible Assets | 0.8% | b3 | ↑ | b2 | Expected trend | |
| Combined Solvency Score | | caa1 | | b3 | | |
| Liquidity | | | | | | |
| Funding Structure | | | | | | |
| Market Funds / Tangible Banking Assets | 12.8% | b2 | ←→ | b2 | | |
| Liquid Resources | | | | | | |
| Liquid Banking Assets / Tangible Banking Assets | 37.8% | b2 | ←→ | caa1 | Stock of liquid assets | |
| Combined Liquidity Score | | b2 | | b3 | | |
| Financial Profile | | | | b3 | | |
| Business Diversification | | | | 0 | | |
| Opacity and Complexity | | | | 0 | | |
| Corporate Behavior | | | | 0 | | |
| Total Qualitative Adjustments | | | | 0 | | |
| Sovereign or Affiliate constraint: | | | | B1 | | |
| Scorecard Calculated BCA range | | | | b2-caa1 | | |
| Assigned BCA | | | | b3 | | |
| Affiliate Support notching | | | | 0 | | |
| Adjusted BCA | | | | b3 | | |

| **Instrument class** | **Loss Given Failure notching** | **Additional Notching** | **Preliminary Rating Assessment** | **Government Support notching** | **Local Currency Rating** | **Foreign Currency Rating** |
|---|---|---|---|---|---|---|
| Counterparty Risk Assessment | 1 | 0 | b2 (cr) | 1 | B1 (cr) | -- |
| Deposits | 0 | 0 | b3 | 1 | B2 | B2 |
| Senior unsecured bank debt | 0 | 0 | b3 | 1 | B2 | B2 |

*Source: Moody's Financial Metrics*

## Ratings

Exhibit 6

| Category | Moody's Rating |
|---|---|
| **STERLING BANK PLC** | |
| Outlook | Stable |
| Bank Deposits -Fgn Curr | B3/NP |
| Bank Deposits -Dom Curr | B2/NP |
| Baseline Credit Assessment | b3 |
| Adjusted Baseline Credit Assessment | b3 |
| Counterparty Risk Assessment | B2(cr)/NP(cr) |
| Issuer Rating | B2 |
| ST Issuer Rating | NP |

*Source: Moody's Investors Service*

REPORT NUMBER 1099821

## CLIENT SERVICES


| | |
|---|---|
| Americas | 1-212-553-1653 |
| Asia Pacific | 852-3551-3077 |
| Japan | 81-3-5408-4100 |
| EMEA | 44-20-7772-5454 |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