MOODY'S INVESTORS SERVICE

CREDIT OPINION
12 June 2019

Update

Rate this Research

RATINGS

Sterling Bank Plc

Domicile	Lagos, Nigeria
Long Term CRR	B2
Type	LT Counterparty Risk Rating - Fgn Curr
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.

Contacts

Peter Mushangwe, CFA +44.20.7772.5224
Analyst
peter.mushangwe@moodys.com

Elena Ioannou +44.20.7772.1716
Associate Analyst
elena.ioannou@moodys.com

Akin Majekodunmi, CFA +44.20.7772.8614
VP-Sr Credit Officer
akin.majekodunmi@moodys.com

Constantinos Kypreos +357.2569.3009
Senior Vice President
constantinos.kypreos@moodys.com

Sterling Bank Plc

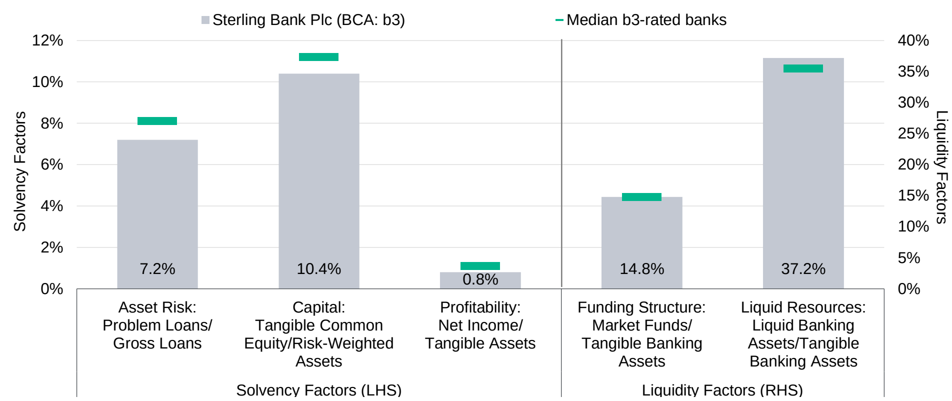
Update to credit analysis

Summary

Sterling Bank Plc's (Sterling) local-currency deposit ratings of B2/Not Prime (NP) incorporate a one-notch uplift from the bank's Baseline Credit Assessment (BCA) of b3, reflecting our assumption of a high probability of the bank receiving support from the Government of Nigeria (B2 stable) in times of need. We also assign foreign-currency deposit ratings of B3/NP to Sterling, which are constrained by the relevant country ceiling; Counterparty Risk Ratings (CRR) of B2/NP; and a Counterparty Risk (CR) Assessment of B2(cr)/NP(cr). The outlook on the bank's long-term ratings is stable.

Sterling's ratings, specifically the BCA, reflect its deposit-based funding profile and stable local-currency liquidity. These positives are balanced against (1) low foreign-currency liquidity buffers; (2) vulnerabilities in its asset quality because of high single-name and sector concentration risks; and (3) modest capital levels, especially in light of high asset risks and high foreign-currency loans. The bank's ratings also reflect Nigeria's still-difficult operating environment, although improving, which will exert negative pressure on the bank's asset quality, while straining its revenue-generating opportunities.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Investors Service

Credit strengths

» Resilient deposit-based funding profile and decent local-currency liquidity buffers

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

» High probability of government support in times of need, which underpins its deposit ratings

Credit challenges

» High asset risks, stemming from elevated sector and single-name concentrations, and high exposure to foreign-currency loans amid a still-difficult operating environment

» A moderate capitalisation level as indicated by the bank's modest proportion of tangible common equity (TCE) to risk-weighted assets

» Tighter foreign-currency funding position, although it is improving, and will be less acute

Outlook

The outlook on Sterling's long-term ratings is stable, reflecting our expectation that the bank's pre-provision income will withstand credit costs and its credit fundamentals will remain in line with similarly rated banks.

Factors that could lead to an upgrade

» A material and sustained improvement in the bank's solvency metrics, particularly its capital, asset risk and profitability metrics, and liquidity metrics may exert upward pressure on its ratings.

» The ratings could be upgraded if Nigeria's rating is upgraded.

Factors that could lead to a downgrade

» Sterling's ratings could be downgraded if there is a deterioration in the bank's asset quality, capital or liquidity beyond a level that is already assumed in the ratings.

» The bank's ratings could also be downgraded in the event of a downgrade of the Nigeria's rating or if we assess that the government's willingness to provide support in the future will decline below our current assumption of high support.

Key indicators

Exhibit 2
Sterling Bank Plc (Consolidated Financials) [1]

	03-19[2]	12-18[2]	12-17[2]	12-16[2]	12-15[2]	CAGR/Avg.[3]
Total Assets (NGN Million)	1,133,407.0	1,102,921.0	1,072,201.0	834,192.0	799,451.4	11.3[4]
Total Assets (USD Million)	3,139.6	3,034.2	2,978.3	2,648.4	4,016.3	(7.3)[4]
Tangible Common Equity (NGN Million)	103,704.0	100,548.0	102,098.0	94,949.0	93,411.9	3.3[4]
Tangible Common Equity (USD Million)	287.3	276.6	283.6	301.4	469.3	(14.0)[4]
Problem Loans / Gross Loans (%)	--	6.1	6.1	9.3	4.6	6.5[5]
Tangible Common Equity / Risk Weighted Assets (%)	--	10.4	10.9	11.6	13.7	11.7[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	--	32.7	30.9	42.8	14.9	30.3[5]
Net Interest Margin (%)	5.6	5.3	5.4	6.7	5.0	5.6[5]
PPI / Average RWA (%)	--	1.5	1.8	2.3	2.6	2.0[6]
Net Income / Tangible Assets (%)	1.1	0.8	0.7	0.6	1.3	0.9[5]
Cost / Income Ratio (%)	81.1	82.8	76.7	74.6	73.0	77.6[5]
Market Funds / Tangible Banking Assets (%)	14.1	14.8	20.9	12.8	7.6	14.0[5]
Liquid Banking Assets / Tangible Banking Assets (%)	37.5	37.2	26.5	27.7	52.2	36.2[5]
Gross Loans / Due to Customers (%)	81.5	84.2	90.2	81.5	60.0	79.5[5]

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

Profile

Sterling Bank Plc (Sterling) 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 March 2019, it held a market share of 2.8% in terms of total assets.

As of March 2019, Sterling distributed its products and services through a network of 179 business offices and 847 ATMs nationwide. It reported total consolidated assets of NGN1,133 billion (about $3.1 billion).

Sterling was established in 1960 as a private liability company, NAL Bank Plc. As part of consolidation reforms introduced by the Central Bank of Nigeria in 2004, NAL Bank Plc merged with Indo-Nigeria Merchant Bank, Magnum Trust Bank, NBM Bank Limited and Trust Bank of Africa Limited in 2006 to form Sterling Bank Plc. Sterling's shares are listed on the Nigerian Stock Exchange. As of March 2019, the bank's largest shareholder was Silverlake Investment Limited, which owned 25% of its total capital.

For further information on the bank's profile, see Sterling Bank Plc - Key Facts and Statistics: Nine Months September 2018.

Detailed credit considerations

High asset risk reflects single-name and sector concentrations

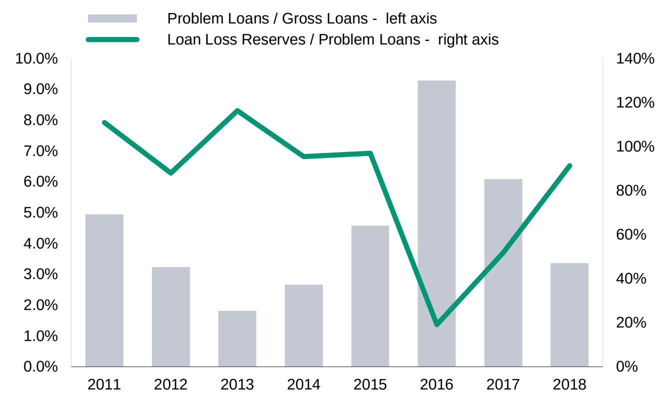
An important factor driving Sterling's BCA is its volatile asset quality, which is still strained by Nigeria's operating environment.

The bank's reported NPL ratio increased to 8.9% as of March 2019 from 6.1% as of December 2017. This ratio is below 11.7%[1], the average for Nigerian banks.

However, Sterling's loan book is more likely to experience greater asset-quality volatility than that of other large domestic commercial banks. This is because Sterling's strategy is centred around servicing the value chain of Nigerian corporates, with most of these corporates tending to be smaller in size than those serviced by larger domestic banks. As a result, these borrowers tend to have limited balance-sheet and cash flow flexibility, driving fluctuations in Sterling's asset quality, as indicated by its Moody's-adjusted NPL ratio of 8.9% in March 2019, 6.1% in 2017, 9.3% in 2016 and 4.6% in 2015 (see Exhibit 3).

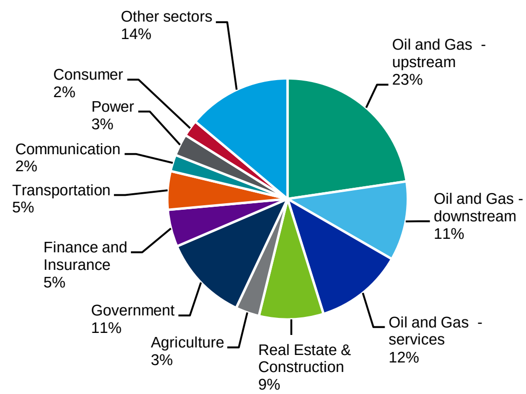
Furthermore, asset risks will continue to stem from the bank's high single-name and sector concentrations, and foreign-currency loans. Sterling's loan portfolio is skewed towards the oil and gas industry, which contributed 45% to its total loans as of March 2019 (see Exhibit 4), higher than the system's average of about 30%. As of the same date, foreign-currency loans constituted about 30% of the bank's total loans, which is sizeable, although it is below that of an average Nigerian bank. The bank's high single-name concentrations will strain its asset quality because a default by a few obligors would increase its NPLs. The large exposure to the oil and gas sector exposes the bank to high asset risks during periods of low oil prices, when upstream and service sector companies' profitability and cash flow are strained, while the high proportion of foreign-currency loans exposes the bank to an elevated risk of default by unhedged clients, when the naira depreciates.

Exhibit 3
NPLs have been volatile, but the NPL ratio will likely stabilise over the next 12-18 months ...



Source: The bank; Moody's Investors Service

Exhibit 4
... although concentration risk will remain high, increasing asset risks
Loan concentration, March 2019



Sources: The bank, Moody's Investors Service

However, Sterling's new strategy focuses on reducing sectoral concentrations by diversifying into sectors such as health, education, renewable energy and transport and logistics, which still have low contributions to its total loan book. Furthermore, Sterling has invested in its IT infrastructure, improving its risk management processes and procedures, and overall governance. We expect future volatility in asset quality to likely be lower than that in the past few years; however, we do not expect significant improvements in NPLs amid Nigeria's still-difficult operating environment.

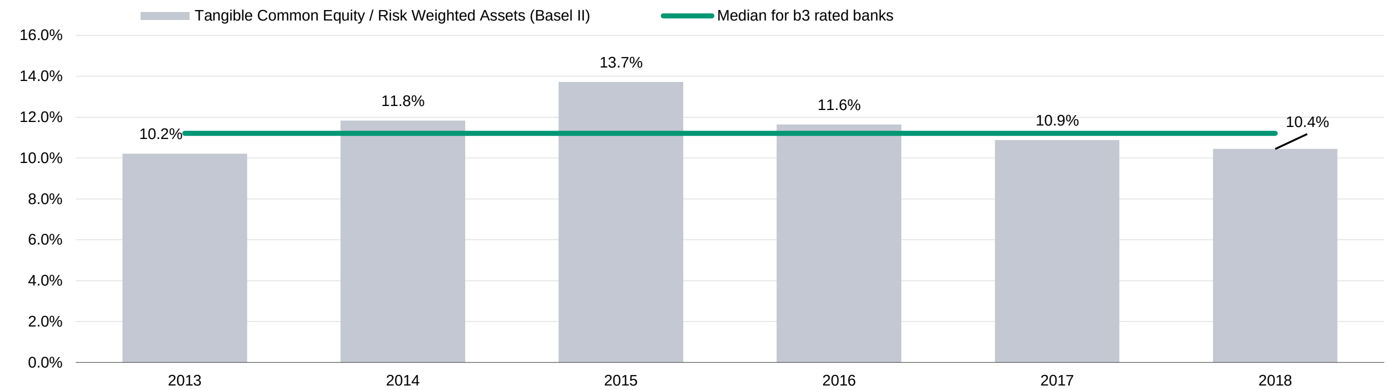
Capitalisation to remain suppressed by weak profitability

Sterling's capitalisation metrics are weaker than those of its global peers that are assigned a BCA of b3. Its relatively weaker efficiency and low profitability reduce the bank's ability to generate capital by retaining profits.

Sterling's reported total capital adequacy ratio was 12.9% as of March 2019, which is lower than the 15.2% of the Nigerian banking system[2]. Moody's adjusted TCE ratio for Sterling was 10% as of December 2018, a decline of 50 basis points from the 2017 level, and marginally lower than that of its global peers with b3 BCAs (see Exhibit 5). The bank's shareholders' equity/total assets was 9.5% as of March 2019, which is lower than the 11.4% median for banks with b3 BCAs, although it shows moderate leverage.

In addition to its modest capital, Sterling has a lower provision coverage than that of its global peers with b3 BCAs, although it increased its provisions to 76% of NPLs as of March 2019 from 52% as of December 2017. The bank's relatively low provision coverage is likely to add to the negative pressure on its capital, if any unexpected loan losses occur.

Exhibit 5
Sterling's TCE ratio declined in 2018 and is weaker than the median of its global peers
TCE/risk-weighted assets



2013 is Basel I ratios; 2014-18 are Basel II ratios.
Source: Moody's Investors Service

Sterling's capital, as is the case with other Nigerian banks, remains vulnerable to exchange-rate volatility because of the bank's high exposure to foreign-currency loans. As of March 2019, 30% of the bank's loan book was denominated in foreign currency, and a naira depreciation would inflate the bank's risk-weighted assets, thus reducing its capital ratios.

Sterling's profitability is weaker than that of its global peers. The bank's pre-provision income/average total assets was 1.4% in the first three months of 2019, which is lower than its global peers' average of 2.7%. Sterling's cost of deposits tends to be higher, which suppresses its net interest margin, while its elevated credit costs further strain its net profitability. Although the bank's interest expense/ total funding liabilities decreased in 2018, it remained high at 6.5% in the first three months of 2019. However, the bank's non-interest income supported its revenue, contributing to 28% of its total revenue in the first three months of 2019. We expect the bank's net income to remain moderate.

Sterling reported a relatively weak efficiency, with reported cost/income of 80% as of March 2019. However, the relatively high cost base is partly explained by the bank's continued investments in its branch network, digital platforms and various retail products, and we expect some improvements in the bank's efficiency metrics as it gains scale from these investments. Sterling's net income/tangible assets was 1.2% during the first three months of 2019, and this relatively low return on assets constrains the bank's ability to grow its capital organically.

Resilient local currency deposit base is balanced by a tighter foreign-currency funding position, although now manageable

Sterling is predominantly deposit funded with a moderate reliance on confidence-sensitive market funds. As of March 2019, customer deposits constituted 76% of the bank's non-equity funding. However, similar to most Nigerian banks, a large amount of Sterling's deposits are sourced from corporates and institutions instead of individuals. We view corporate deposits as more volatile and more confidence sensitive. Having said that, the bank's deposits are relatively diversified, with the top 20 depositors contributing to about 20% of its total deposits.

Similar to other Nigerian banks, Sterling held a tighter foreign-currency funding position, although it improved significantly over 2018. As of year-end 2018, Sterling's proportion of US dollar loans/ US dollar deposits was 97% compared with 181% as of December 2017, because the bank expanded its US dollar deposits. However, Sterling's liquid assets buffer is modest, with a liquid banking assets/ tangible banking assets ratio of 38% as of December 2018. As of December 2018, Sterling's liquid foreign-currency assets/total foreign-currency assets stood at 11%. Given the improving foreign-currency liquidity in the system and rising foreign-currency deposits, we expect the bank's foreign-currency liquidity to improve, supporting its overall liquidity.

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 9 August 2018.

Support and structural considerations

Government support

The bank's local-currency deposit rating of B2 with a stable outlook incorporates one notch of rating uplift from its b3 BCA, based on our assessment of a high probability of the bank receiving government support in times of financial stress. The Nigerian government demonstrated a strong willingness to support banks in the last crisis through recapitalisations and balance-sheet clean-ups via outright purchases of NPLs by the Asset Management Corporation of Nigeria. Furthermore, Nigerian regulatory authorities do not currently have bail-in powers that allow them to impose losses on creditors outside of a liquidation process.

Counterparty Risk (CR) Assessment

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 (for example, swaps), letters of credit, guarantees and liquidity facilities.

Sterling's CR Assessment is positioned at B2(cr)/NP(cr)

Sterling's CR Assessment is one notch higher than its b3 BCA because senior obligations, represented by the CR Assessment, will likely be preserved to limit contagion, minimise losses and avoid a disruption of critical functions.

Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions

Sterling's CRRs are positioned at B2/NP

National scale rating (NSR)

Sterling's national scale ratings (NSRs) 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). Our NSRs are given a two-letter suffix to distinguish them from the global scale ratings. For example, NSRs in Nigeria have the country abbreviation “ng.”

Sterling's NSRs capture the bank's predominantly deposit-funded base and improvements in the bank's IT infrastructure and risk management processes. These strengths are balanced by low foreign-currency liquidity buffers, which underpin the lower foreign-currency deposit NSR than that of its local-currency deposit NSR; vulnerabilities in asset quality because of high single-name and sector concentration risks (for example, oil and gas loans constitute 45% of its gross loans); and relatively modest capital levels, especially compared with the bank's high foreign-currency loan exposure (30% of its gross loans).

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (although 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 6

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	7.2%	caa1	↓	caa1	Sector concentration	Single name concentration
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel II)	10.4%	caa1	←→	caa1		
Profitability						
Net Income / Tangible Assets	0.8%	b3	←→	b2	Expected trend	
Combined Solvency Score		caa1		caa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	14.8%	b2	←→	b2	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	37.2%	b2	←→	b2	Stock of liquid assets	
Combined Liquidity Score		b2		b2		
Financial Profile				b3		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				B2		
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 Rating	1	0	b2	0	B2	B2
Counterparty Risk Assessment	1	0	b2(cr)	0	B2(cr)	
Deposits	0	0	b3	1	B2	B3

[1]Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
STERLING BANK PLC	
Outlook	Stable
Counterparty Risk Rating	B2/NP
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

Endnotes

1 As of December 2018, International Monetary Fund.

2 As of December 2018, International Monetary Fund.

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