FitchRatings

Banks
Universal Commercial Banks
Nigeria

Sterling Bank Plc

Key Rating Drivers

Standalone Strength Drives IDRs: Sterling Bank Plc's Issuer Default Ratings (IDRs) are driven by its standalone creditworthiness, as expressed by its Viability Rating (VR) of 'b-'. The VR reflects Sterling's sensitivity to Nigeria's challenging operating environment, a fairly small franchise, high credit concentrations and foreign currency (FC) liquidity weaknesses.

Stable Outlook: The Stable Outlook reflects Fitch Ratings' view that risks to Sterling's credit profile are captured at the current rating, with sufficient headroom under the agency's base case to absorb the fallout from operating environment pressures.

Small Franchise: Sterling operates exclusively in Nigeria under a national banking licence and has fairly small market shares, representing 3% of banking system assets at end-2020.

High Credit Concentrations: Single-borrower concentration is high, with the 20-largest customer loans representing 286% of Fitch Core Capital (FCC) at end-1H21. Oil and gas exposure is also high, representing 26% of gross loans or 139% of FCC at end-1H21, and concentrated on the riskier upstream and services segments.

Good Asset Quality: Sterling's impaired loans ratio declined to 1.9% at end-9M21 from 2.9% at end-9M20 owing to write-offs and robust loan growth in 9M21 and remains among the lowest across the banking sector. Specific loan loss allowance coverage of impaired loans (98% at end-9M21) is particularly high by domestic standards, reflecting intended write-offs.

Adequate Profitability: Operating returns on risk-weighted assets have averaged 1.4% over the past four full years. Profitability is notably lower than Nigeria's five largest banks due to weaker revenues and higher operating expenses. Profitability softened slightly in 9M21 as a result of continued margin pressure from lower fixed income yields.

Reasonable Capitalisation: Sterling's FCC ratio declined to 14.7% at end-9M21 from 16.8% at end-2020 as a result of robust loan growth. Asset quality does not compromise Sterling's capital position and pre-impairment operating profit provides a moderate buffer to absorb potential loan impairment charges through the income statement. Sterling's Total Capital Adequacy Ratio (CAR; 14.3% at end-9M21) is comfortably above its 10% regulatory requirement.

Tight Foreign Currency Liquidity: Sterling's loans/customer deposits ratio (61% at end-9M21) is relatively low, reflecting the relatively liquid structure of its balance sheet. Local-currency liquidity coverage is comfortable, but FC liquidity is tighter than peers', particularly in view of very high single-depositor concentration in US dollars.

National Ratings: Sterling's National Ratings reflect its creditworthiness relative to other issuers in Nigeria and are driven by its standalone creditworthiness.

Rating Sensitivities

Improved Franchise and Funding Diversification: An upgrade of the VR and Long-Term IDR would require an improved company profile, which may be indicated by increased market shares and a reduction in FC single-depositor concentration risk.

Capital Pressures: A combination of an increase in the impaired loans ratio above 10% and aggressive growth that results in very thin buffers over regulatory capital requirements or a sharp decline in the FCC ratio would result in a downgrade of the VR.

FC Liquidity Pressure: A significant tightening in FC liquidity, most likely due to the crystallisation of single-depositor concentration risk, would result in a downgrade of the VR.

Ratings

Long-Term IDR	B-
Short-Term IDR	B
Viability Rating	b-
Support Rating	5
Support Rating Floor	NF
National	
National Long-Term Rating	BBB+(nga)
National Short-Term Rating	F2(nga)
Sovereign Risk	
Long-Term Foreign-Currency IDR	B
Long-Term Local-Currency IDR	B
Country Ceiling	B

Outlooks

Long-Term IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (November 2021)

National Scale Rating Criteria (December 2020)

Related Research

Fitch Affirms Sterling Bank at 'B-'; Outlook Stable (September 2021)

Fitch Affirms Nigeria at 'B'; Outlook Stable (March 2021)

Nigeria (March 2021)

Nigeria's Petroleum Bill Could Boost Long-Term Oil Production (August 2021)

2022 Outlook: African Banks (December 2021)

Fitch Ratings 2022 Outlook: Sub-Saharan Africa Sovereigns (December 2021)

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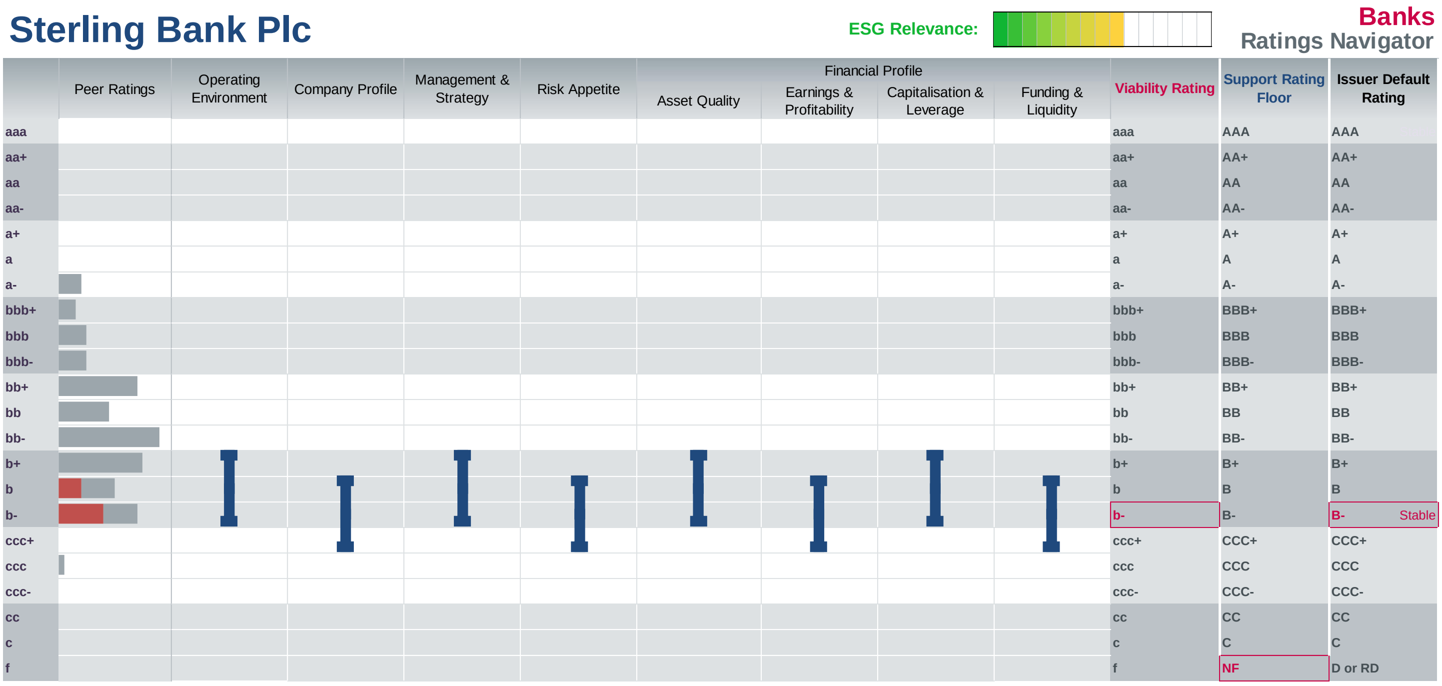
Ratings Navigator



Sovereign Support Assessment

Support Rating Floor			Value
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)			B
Actual country D-SIB SRF			NF
Support Rating Floor:			**NF**
Support Factors	**Positive**	**Neutral**	**Negative**
Sovereign ability to support system			
Size of banking system relative to economy	✓		
Size of potential problem			✓
Structure of banking system		✓	
Liability structure of banking system			✓
Sovereign financial flexibility (for rating level)			✓
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in		✓	
Track record of banking sector support	✓		
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance			✓
Liability structure of bank			✓
Ownership		✓	
Specifics of bank failure		✓	

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colours – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

- ⇧ Positive
- ⇩ Negative
- ⇳ Evolving
- ▫ Stable

High Propensity to Support; Weak Ability

Fitch considers the Nigerian authorities' propensity to support the domestic banking system to be high and there is a record of recent support across the banking sector. However, we believe that extraordinary support from government sources for commercial banks is uncertain given Nigeria's weak ability to support, particularly in FC. As a consequence, the Support Rating Floors of all commercial banks are at 'No Floor', reflecting our view that senior creditors cannot rely on receiving full and timely extraordinary support from the authorities should a bank become non-viable.

Significant Changes

Stabilisation of Nigeria's Operating Environment

Nigeria's real GDP is expected to grow by 1.9% in 2021 following a 1.8% contraction in 2020 amid a rebound in oil prices, an expanding non-oil sector and the absence of renewed social containment measures. However, challenges linger in the form of FC scarcity, currency devaluation, high inflation and regulatory intervention from the Central Bank of Nigeria (CBN).

Our base case is that asset quality metrics are likely to hold up in 2021 (for the Fitch-rated banks the average impaired loans ratio was 6.3% at end-2020) even though support measures are ending. According to the CBN, loans under pandemic-related deferrals represented 38% of total loans at end-4M21. There is a risk that a proportion of these loans will migrate to Stage 2 but a material increase is unlikely.

We believe customers who have exited loan deferrals have resumed payments. New impaired loans are most likely to come from SMEs given the extent of the economic damage on businesses. More positively, current high oil prices are supportive of the banks' asset quality as they take pressure off the upstream sector, a traditionally problematic sector. Oil-related loans represent around 30% of sector loans at end-2020; a large proportion are in FC.

We assume sector loan growth of 10% in 2021, reflecting pent-up demand, currency devaluation (around 40% of sector loans are in USD) and increasing lending to priority sectors. Loan growth will also come from a strategic shift towards consumer lending, with many banks investing in, and rolling out, digital channels.

The low rate environment and modest loan growth will continue to depress earnings and profitability despite a slower pace of provisioning in 2021. Solid non-interest income generation (mainly from fees and commissions and trading income) will continue to underpin results. We believe performance metrics are unlikely to return to pre-pandemic levels for at least another two years. Capitalisation, funding and liquidity remain relative strengths.

Company Summary and Key Qualitative Assessment Factors

Small Franchise

Sterling is a relatively new bank formed in 2006 through a merger of five Nigerian banks in response to higher minimum capital requirements introduced by the CBN. Sterling operates exclusively in Nigeria under a national banking licence and has fairly small market shares, representing 3% of banking system assets at end-2020.

Sterling is one of only five banks to offer Islamic banking (termed 'non-interest banking') services in Nigeria. Non-interest banking represents only a small part of the business (4% of gross loans at end-2020) but has significant growth potential in Nigeria given the country's large Muslim population.

Lending Focused on Small Corporates and Commercial Customers

Sterling's loan book is geared towards riskier customers than its larger peers, including small corporate and commercial customers, reflecting its small balance sheet size and other franchise constraints. Consumer lending is largely salary-assigned lending and represents a small proportion of gross loans (6% at end-2020) but is expected to increase over the medium term. FC lending is moderate by domestic standards (24% of net loans at end-1H21) and typically extended to companies with FC cash flows, thereby eliminating currency mismatches.

Significant Credit Concentrations

Single-borrower concentration is high, with the 20-largest customer exposures representing 53% of gross loans and 139% of FCC at end-1H21. Oil and gas exposure has reduced in recent years but remains material, representing 26% of gross loans and 139% of FCC at end-1H21.

Oil and gas loans tend to be large ticket and prominently feature among the 20-largest loans. The exposure is concentrated in the riskier upstream and services segments (a combined 19% of gross loans at end-9M21), posing a significant risk to asset quality in the event of a prolonged period of low oil prices and productions cuts. In absence of FX devaluations effects, Fitch expects Sterling's oil and gas exposure to decline as a percentage of gross loans over the medium-term as management aims to achieve greater diversification.

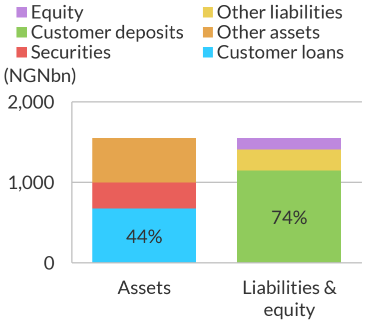
Conservative Asset Structure

Net loans represent a fairly small percentage of total assets (44% at end-9M21), with this contribution having declined in recent years as a result of conservative loan growth between 2018 and 2020. Cash and due from banks (23% of total assets) is the second-largest component, having increased notably in recent years as a result of cash reserve debits by the CBN. Securities (21% of total assets) are dominated by Federal Government of Nigeria (FGN) fixed income instruments. Sovereign exposure through government fixed income securities and CBN reserves is therefore high.

Moderate Balance Sheet Dollarisation

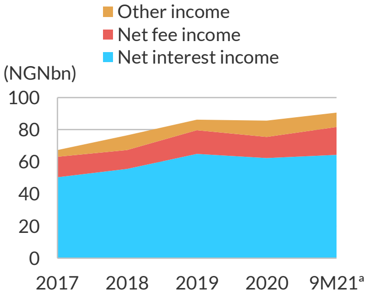
Balance sheet dollarisation is moderate by domestic standards, with FC assets (mainly in US dollars) representing 18% of total assets at end-1H21. However, Sterling had a small long net open position in FC equivalent to 1% of total equity at end-1H21, providing only a limited mitigant against the downward pressure on capital ratios stemming from inflated FC risk-weighted assets that would accompany a devaluation of the Nigerian naira.

Balance Sheet, Sep 21



Source: Fitch Ratings, Sterling Bank Plc

Revenue Breakdown



[a] Annualised data
Source: Fitch Ratings, Sterling Bank Plc

Summary Financials and Key Ratios

	30 Sep 21		31 Dec 20	31 Dec 19	31 Dec 18
	9 months - 3rd quarter	9 months - 3rd quarter	Year end	Year end	Year end
	(USDm)	(NGNbn)	(NGNbn)	(NGNbn)	(NGNbn)
	Unaudited	Unaudited	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement					
Net interest and dividend income	117	48.1	62.4	64.9	55.5
Net fees and commissions	32	13.0	13.1	14.6	11.8
Other operating income	16	6.7	10.1	6.6	9.2
Total operating income	165	67.8	85.5	86.1	76.5
Operating costs	131	53.6	66.3	70.9	62.7
Pre-impairment operating profit	35	14.2	19.3	15.3	13.7
Loan and other impairment charges	11	4.5	7.0	4.7	4.3
Operating profit	24	9.7	12.3	10.6	9.4
Other non-operating items (net)	0	0.1	0.1	0.0	0.0
Tax	1	0.4	1.1	0.1	0.3
Net income	23	9.5	11.2	10.6	9.2
Other comprehensive income	-15	-6.2	5.8	11.2	-3.3
Fitch comprehensive income	8	3.3	17.1	21.8	6.0
Summary balance sheet					
Assets					
Gross loans	1,699	697.2	613.4	631.7	640.7
- Of which impaired	33	13.6	11.4	13.9	39.3
Loan loss allowances	50	20.4	16.5	13.0	19.7
Net loans	1,649	676.8	596.8	618.7	621.0
Interbank	204	83.6	21.1	69.4	43.5
Derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Other securities and earning assets	946	388.3	340.4	291.6	271.0
Total earning assets	2,800	1,148.7	958.3	979.7	935.5
Cash and due from banks	883	362.3	303.3	156.1	117.7
Other assets	90	37.1	37.5	46.9	49.7
Total assets	3,773	1,548.0	1,299.1	1,182.7	1,102.9
Liabilities					
Customer deposits	2,800	1,149.0	950.8	892.7	760.6
Interbank and other short-term funding	122	50.0	46.9	14.8	55.8
Other long-term funding	421	172.8	128.6	125.4	162.5
Trading liabilities and derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Total funding and derivatives	3,343	1,371.8	1,126.4	1,032.8	978.9
Other liabilities	94	38.6	36.9	30.3	26.2
Preference shares and hybrid capital	n.a.	n.a.	n.a.	n.a.	n.a.
Total equity	335	137.6	135.8	119.6	97.8
Total liabilities and equity	3,773	1,548.0	1,299.1	1,182.7	1,102.9
Exchange rate		USD1 = NGN410.3	USD1 = NGN381	USD1 = NGN307	USD1 = NGN306.31

Source: Fitch Ratings, Fitch Solutions, Sterling Bank Plc

Summary Financials and Key Ratios

	30 Sep 21	31 Dec 20	31 Dec 19	31 Dec 18
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.5	1.6	1.4	1.3
Net interest income/average earning assets	6.2	6.6	6.9	6.2
Non-interest expense/gross revenue	79.1	77.4	82.3	82.0
Net income/average equity	9.5	9.0	9.7	9.1
Asset quality				
Impaired loans ratio	1.9	1.9	2.2	6.1
Growth in gross loans	13.7	-2.9	-1.4	3.7
Loan loss allowances/impaired loans	150.0	144.8	93.3	50.0
Loan impairment charges/average gross loans	0.6	0.9	0.7	0.7
Capitalisation				
Common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fully loaded common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fitch Core Capital ratio	14.7	16.8	15.2	12.9
Tangible common equity/tangible assets	8.6	10.1	9.7	8.4
Basel leverage ratio	n.a.	n.a.	n.a.	n.a.
Net impaired loans/common equity Tier 1	n.a.	n.a.	n.a.	n.a.
Net impaired loans/Fitch Core Capital	-5.1	-3.9	0.8	21.5
Funding and liquidity				
Gross loans/customer deposits	60.7	64.5	70.8	84.2
Liquidity coverage ratio	n.a.	n.a.	n.a.	n.a.
Customer deposits/total non-equity funding	83.8	84.4	86.4	77.7
Net stable funding ratio	n.a.	n.a.	n.a.	n.a.

Source: Fitch Ratings, Sterling Bank Plc

Key Financial Metrics – Latest Developments

Good Asset Quality

Sterling's impaired loans (Stage 3 loans under IFRS 9) ratio increased to 2.9% at end-9M20 from 2.2% at end-2019 as a result of the economic implications of the pandemic, but has declined notably to 1.9% at end-9M21 owing to write-offs and robust loan growth in 9M21. Specific loan loss allowance coverage of impaired loans (98% at end-9M21) is among the highest in the banking sector, partly reflecting the intention to write-off the largest two impaired loans, which should drive further improvement in the impaired loans ratio.

Stage 2 loans increased significantly to 21% of gross loans at end-2020 from 11% at end-2019 as a result of the classification of some large upstream oil and gas and transport sector exposures that were restructured at the onset of the pandemic. However, Stage 2 loans have experienced significantly improved cash flows, resulting in reclassifications and a decline in the ratio to 14% at end-9M21. Fitch expects further reclassifications in 4Q21.

Adequate Profitability

Sterling delivers adequate profitability, as indicated by operating returns on risk-weighted assets that have averaged 1.4% over the past four full years. Adequate profitability is supported by a reasonable net interest margin (NIM) and healthy non-interest income but is constrained by high operating expenses, reflecting limited economies of scale, and loan impairment charges that tend to erode a high percentage of pre-impairment operating profit.

Operating returns on risk-weighted assets increased from 1.4% in 2019 to 1.6% in 2020 despite the onset of the pandemic. The slight improvement, which was against a backdrop of margin pressure, softer client activity and a slight uptick in loan impairment charges, was driven by improved trading income and more efficient cost management. Operating returns on risk-weighted assets weakened slightly to 1.5% in 9M21 on an annualised basis, primarily reflecting continuing margin pressure from the collapse in fixed income yields.

Reasonable Capitalisation

Capitalisation has improved in recent years, as indicated by the increase in Sterling's FCC ratio to 16.8% at end-2020 from 12.9% at end-2018, which was driven by conservative loan growth. However, Sterling's FCC ratio declined to 14.7% at end-9M21 as a result of strong loan growth.

Asset quality does not compromise Sterling's capital position, with impaired loans net of specific loan loss allowances representing just 0.2% of FCC at end-9M21. Furthermore, pre-impairment operating profit, which has equalled 2.6% of average gross loans over the past full years, provides a moderate buffer to absorb loan impairment charges without affecting capital.

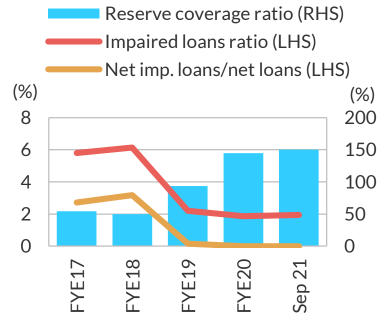
Sterling's CAR (14.3% at end-9M21 excluding unaudited interim retained earnings) is comfortably above the 10% minimum regulatory requirement for a bank with a national license.

Tight Foreign Currency Liquidity

The customer deposit base comprises a fairly high percentage of current and savings accounts (74% of customer deposits at end-9M21) and a moderate proportion of retail deposits (estimated at 34%), which supports funding stability. Single-depositor concentration is moderate, with the 20-largest deposits representing 20% of total customer deposits at end-1H21, and reliance on non-deposit funding is low (16% of non-equity funding at end-9M21).

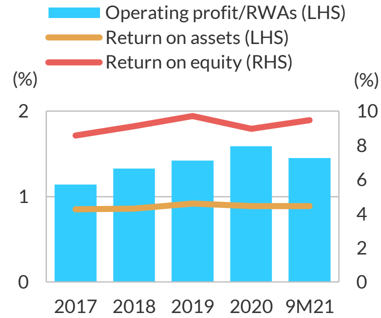
The funding profile is moderately dollarised. FC funding is mainly in the form of customer deposits (80% of FC liabilities at end-1H21). Single-depositor concentration is extremely high in FC, with the 20-largest FC deposits representing 56% of FC customer deposits at end-1H21, and the 2 largest FC customer deposits representing a combined 34% of FC customer deposits. FC liquidity coverage is weak in view of high single-depositor concentration, with holdings of FC liquid assets representing just 24% of customer FC deposits.

Asset Quality



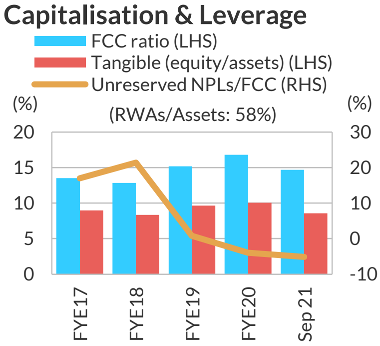
Source: Fitch Ratings, Sterling Bank Plc

Profitability



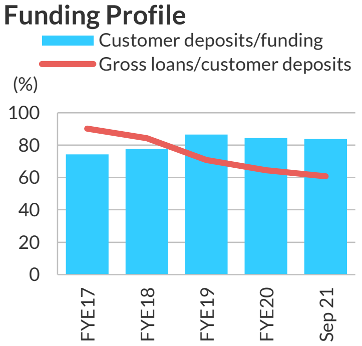
Source: Fitch Ratings, Sterling Bank Plc

Capitalisation & Leverage



Source: Fitch Ratings, Sterling Bank Plc

Funding Profile



Source: Fitch Ratings, Sterling Bank Plc

Environmental, Social and Governance Considerations

FitchRatings **Sterling Bank Plc**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Sterling Bank Plc has 5 ESG potential rating drivers

- Sterling Bank Plc has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE
How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

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