TCM funds not losing interest in Nigerian biggest lenders

The Nigeria Stock Exchange All Share Index has dropped 10% this year, compared with a 15% gain in an index of frontier markets. Foreign investors are frustrated over a lack of policy progress since President Muhammadu Buhari won re-election in February. The Nigerian economy is struggling to recover from a full-year contraction in 2016 and the International Monetary Fund forecasts that growth will accelerate to 2.1% this year from 1.9% in 2018. That would still leave it as one of Africa's slowest-growing economies and will be below the rate of population growth, which is almost 3%. The United Nations projects that the overall population of Nigeria will reach about 398 million by the end of the year 2050. With those numbers Nigeria will be the third most populated country in the world after China and India.

The country is already in desperate need of infrastructure investments given the constant electricity outages and chaos at the main ports, both of which weigh on economic growth. However, since so few Nigerians and companies pay tax, the nation has one of the lowest revenue-to-GDP ratios in the world at about 7%. That leaves the government with little money to spend on schools, hospitals and infrastructure. There is also a growing concern of how much of the budget is soaked up by interest payments. Still, Buhari is an advocate of low gasoline prices, believing they're one of the few benefits that Nigerians get from the state. Nigeria is the sixth cheapest country in the world in which to fill up your tank. That cost almost $2 billion in subsidies last year, according to the IMF, which has urged the government to raise prices.

Credit growth is expected to remain subdued as the economy remains underperforming but Nigeria's biggest banks have found a way of shielding earnings from another year of tepid credit demand by buying up local government bonds that offer among the highest yields in emerging markets. Banks, for example, can buy 364-day treasury bills at a yield of around 15 percent, a near-risk free way of making money. Therefore there is little incentive to lend and that is exactly what the regulator wants to change.

In an effort to boost economic growth Nigeria is giving its banks a choice: lend more money, or hand it over to the central bank and earn nothing on it. Banks should use at least 60% of their deposits for loans by the end of September, the central bank said. Those that don't will have their cash-reserve requirements increased, meaning they'll be forced to park more money at the central bank. Nigeria's banks are some of the most reluctant lenders in major emerging markets, with an average loan-to-deposit ratio below 60%. That compares with 78% across Africa, according to data compiled by Bloomberg. It's above 90% in South Africa and about 76% in Kenya.

The circular from the central bank actually contributed to significant sell-offs. An index of local banking stocks has dropped 23% from its 2019 high reached in February. Lenders worry that being forced to lend under the current macro-economic situation, with inflation at more than 11%, could endanger the financial system through an increase in non-performing loans, or NPLs. They just came out from a period of high NPLs after the crisis three years ago. With non-performing loans down to below 10% compared with 17% a year or two ago, banks are very cautious of credit growth at this time.

However the soup might not be eaten as hot as it is served and as often a market under stress can offer interesting buying opportunities for the longer term. Especially for the nation's biggest lenders, such as Guaranty Trust Bank, United Bank for Africa (UBA) and Zenith Bank who have strong balance sheets and relatively clean non-performing loan books with a NPL ratios of around 5%. These three banks currently trade at only 3-4 times earnings which represents a discount of 35% to their 5-year historical average. Although the Nigerian stock market has been ravaged several times by market corrections and devaluations in the past 15 years, Guaranty (+18%), UBA (+6.7%) and Zenith (+9.8%) showed their resilience with decent annual equivalent returns (in euro) compared to an index annual equivalent of -1.1% over the period. With this in mind and given their solid dividend yields, ROE's and expected earnings per share (EPS) growth TCM funds is confident in holding these names in portfolio.

A development that could pose a positive catalyst for the market in the near future is the petroleum bill. An overhaul of oil policy that's been in the works for more than a decade is among a raft of laws President Muhammadu Buhari could steer through parliament in his second term to help drive investment in the oil-dependent economy. The delays of this overhaul has cost an estimated $15 billion a year in lost funding for the industry over the past decade, according to the Petroleum Ministry. As a result, Nigeria's crude output and reserves have stagnated and targets to reach reserves of 40 billion barrels and output of 4 million barrels a day have been pushed back more than 15 years. The reforms stated in the petroleum bill, if it passes this time, will drive the much needed investments in oil exploration and production that have been withheld because of policy uncertainty.

TCM Investment Funds
July 2019

Overview 3 Nigerian Banks:

UBA	FY2017	FY2018	FY2019F	FY2020F
EPS	2,17	2,3	2,64	2,91
P/E (x)	5,01	3,2	2,68	2,42
P/B (x)	0,81	0,54	0,41	0,37
Div Yield	5,50%	7,20%	6,40%	6,80%
Payout Ratio	30%	37%	28%	27%
ROE	16,10%	15,20%	15,40%	15,20%

Guaranty	FY2017	FY2018	FY2019F	FY2020F
EPS	5,79	6,27	6,86	7,52
P/E (x)	5,35	4,94	4,52	4,12
P/B (x)	1,47	1,59	1,53	1,41
Div Yield	8,71%	8,87%	9,19%	9,68%
Payout Ratio	47%	44%	40%	40%
ROE	27,11%	32,08%	33,73%	34,30%

Zenith	FY2017	FY2018	FY2019F	FY2020F
EPS	5,67	6,16	6,49	6,95
P/E (x)	3,63	3,34	3,17	2,96
P/B (x)	0,79	0,79	0,78	0,74
Div Yield	13,14%	13,63%	14,11%	14,60%
Payout Ratio	48%	45%	45%	43%
ROE	21,91%	23,71%	24,76%	24,92%

Sources:
*Juicy Nigerian yields may just spare banks from profit pains, Bloomberg Feb 19, 2019
*Growth-Hungry Nigeria tells banks to use or lose their money, Bloomberg Jul 4, 2019
*Nigeria Stocks extend slump on policy delays, central banks steps, Bloomberg Jul 16, 2019
*Nigeria urges banks to lend or lose access to yields of 14%, Bloomberg, May 22, 2019
*Nigeria's first-quarter GDP slows after oil sector contracts, Bloomberg, May 20, 2019
*Guaranty Trust Bank Plc, PAC Research, May 14, 2019
*Zenith Bank Plc, PAC Research, May 7, 2019
*United Bank for Africa, Coronation research, April 24, 2019