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Research Update:

First Bank of Nigeria Lowered To 'B-/C' On Weak Asset Quality And High Credit Losses; On CreditWatch Negative

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Overview

- Economic slowdown and restrictive foreign exchange policy in Nigeria has undermined domestic banks' creditworthiness.
- As a result, First Bank of Nigeria's (FirstBank's) asset quality has deteriorated markedly in 2015 and credit losses jumped to levels beyond our base-case expectations. We anticipate that FirstBank's credit cost will be high in 2016, thus weakening earnings and capitalization.
- Therefore, we are lowering our long- and short-term global and national scale ratings on FirstBank to 'B-/C' from 'B+/B' and to 'ngBB/ngB' from 'ngA-/ngA-2', respectively, and placing the long-term ratings on CreditWatch negative.
- The CreditWatch placement reflects our view that the bank's financial profile could deteriorate further on the back of naira devaluation.

Rating Action

On June 22, 2016, S&P Global Ratings lowered its long- and short-term counterparty credit ratings on Nigeria-based First Bank of Nigeria Ltd. (FirstBank) to 'B-/C' from 'B+/B'. We also lowered our long- and short-term national scale ratings on FirstBank to 'ngBB/ngB' from 'ngA-/ngA-2'. We placed the long-term ratings on CreditWatch with negative implications.

At the same time, we placed on CreditWatch with negative implications our 'B-' long-term global scale counterparty credit rating on FirstBank's nonoperating holding company (NOHC), FBN Holdings PLC (FBNH). We lowered our long-term national scale rating on FBNH to 'ngBB' from 'ngBB+' and also placed it on CreditWatch negative. We affirmed our 'C' short-term global scale and 'ngB' short-term national scale ratings on FBNH.

Rationale

The rating actions reflect our view that FirstBank will continue to exhibit comparatively weaker asset quality metrics than rated top-tier banks in Nigeria and lower earnings than its peers in 2016 due to high credit cost. The low-oil-price environment, combined with high concentration in the oil and gas sector, has undermined the bank’s revenue and earnings stability and asset quality, resulting in markedly higher nonperforming loans (NPLs) than we anticipated. We expect that moderate real GDP growth and a prolonged depreciation of the local currency will drive up credit losses in the banking system to between 3%-4% in 2016-2017 and threaten the capital position of some Nigerian banks.

We observe that FirstBank has not been able to manage down some of its exposures in foreign currency, following the naira devaluation in 2014 and early 2015, and as a result exhibits weaker underwriting standards than its peers. Moreover, the bank exhibits high concentration risk: The top 20 loans accounted for 43.5% of total loans at year-end 2015, with the largest two exposures being nonperforming. As a result, we believe that FirstBank exhibits a moderate business position, stemming from lapses in risk management.

Cost of risk jumped to 5.7% at year-end 2015 from 1.3% in 2014, and NPLs increased to 18% in the same period, compared with less than 3% in 2014. More importantly, we expect cost of risk to remain high at about 5% over the next 12-18 months and NPLs to increase to around 22% compared with our estimate of 6% for the sector on average in 2016. The weak performance of the bank’s portfolio stems from its significant concentration on foreign currency loans, particularly the oil and gas related exposures. FirstBank’s share of foreign currency lending was high at 45% of total loans in 2015. In a context of low oil prices and a weakening naira, we expect additional impairments in 2016, which will result in additional NPLs in this segment. At year-end 2015, the bank restructured 12% of its portfolio, with the oil and gas sector accounting for 70% of the restructured portfolio. We expect FirstBank to restructure some loans, particularly in downstream oil and gas and small and midsize enterprises in 2016, on the back of the naira depreciation. The 2015 performance and huge impairments prompted the bank to launch a review of its risk-management process to improve loan approvals, risk monitoring, and collection.

As a result, we now assess the bank’s risk position as moderate compared with adequate previously.

FirstBank reduced its off-balance-sheet exposures by 50% year on year at end-2015, which resulted in an improvement of its risk-adjusted capital (RAC) ratio to 5.7%, compared with 4.6% a year earlier. However, we anticipate that our RAC ratio calculation will deteriorate to weaker levels of about 3.8%-4.0% over the next 12-18 months on the back of high impairments and naira devaluation.

Furthermore, the restrictive foreign exchange regime, as well as lower oil prices and production, has resulted in a shortage in U.S. dollars, which is undermining the banking sector's foreign currency liquidity position. FirstBank raised U.S. dollar funding in 2013 and 2014, which should provide a natural hedge to its capitalization in the scenario of naira devaluation. However, there is a risk that the bank’s capital adequacy ratio could go below the minimum regulatory requirement of 15%, should the naira devalue beyond our base-case scenario.

The ratings on the bank reflect the overall creditworthiness of the FirstBank group, whose group credit profile (GCP) we assess at 'b-'. The bank is the core component of the group, which is at the top of the Nigerian financial services industry, with a leading deposit franchise and good naira liquidity.

Despite the bank's high systemic importance, the ratings on FirstBank reflect our assessment of the bank's core group status to the FirstBank group and its stand-alone credit profile (SACP) at 'b-'. We classify the Nigerian government as supportive of the domestic banking sector, but we do not add extraordinary government support to the bank's SACP.

Our long- and short-term ratings on FirstBank's holding company FBNH are at the same level as the ratings on FirstBank, at 'B-/C', reflecting the absence of debt at the holding company level. Under our criteria, we generally notch down from the GCP to reflect the NOHC's structural subordination and exposure to potential regulatory intervention. Nevertheless, in FBNH's case, we take comfort from the absence of debt at the holding company level and believe that the risk of default of the NOHC is not yet commensurate with the 'CCC' rating category. Should we see any emergence of leverage at the NOHC level, its rating will come under significant pressure.

CreditWatch

The negative CreditWatch placement reflects our view that FirstBank’s capital adequacy ratio could fall below the minimum regulatory capital adequacy ratio in case of a devaluation of the naira beyond our base-case scenario. If such a scenario materialized, we would lower the ratings on FirstBank by one notch to 'CCC+'. We could also lower the ratings on FirstBank by one notch if asset quality deteriorated further, leading to higher credit losses and NPLs than anticipated.

The negative CreditWatch placement on FBNH reflects that on the bank. We would lower our ratings on the NOHC by at least one notch if we lowered our ratings on FirstBank. In addition, we could lower the ratings on the NOHC by more than one notch if we saw any emergence of leverage at the NOHC level.

Alternatively, we could affirm the ratings on FirstBank at the current levels if the bank does not breach the minimum regulatory capital adequacy ratio upon the effective devaluation of the naira. In such a case, we would also affirm the ratings on FBNH, providing that all else remained unchanged.

We aim to resolve the CreditWatch within the next 90 days.

Ratings Score Snapshot

	To	From
Holding Company Rating	B-/Watch Neg/C	B-/Stable/C
Issuer Credit Rating	B-/Watch Neg/C	B+/Negative/B
SACP	b-	b+
Anchor	b+	b+
Business Position	Moderate	Adequate
Capital and Earnings	Weak	Weak
Risk Position	Moderate	Adequate
Funding and Liquidity	Above Average and Adequate	Above Average and Adequate
Support	0	0

	To	From
ALAC Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

Related Criteria And Research

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables - June 01, 2016
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions - January 29, 2015
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions - July 17, 2013
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings - October 01, 2012
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework - June 22, 2012
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions - December 06, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks - March 23, 2004

Related Research

- Banking Industry Country Risk Assessment: Nigeria - April 26, 2016
- Negative Rating Actions Taken On Six Nigerian Banks After Sovereign Outlook Revision - March 24, 2016
- Research Update: Federal Republic of Nigeria Outlook Revised To Negative On Oil Price Pressures; 'B+/B' Ratings Affirmed - March 18, 2016
- Analytical Linkages Between Sovereign And Bank Ratings - December 6, 2011

Ratings List

	Rating	
	To	From
FBN Holdings PLC		
Counterparty Credit Rating		
Foreign and Local Currency	B-/Watch Neg/C	B-/Stable/C
Nigeria National Scale	ngBB/Watch Neg/ngB	ngBB+/--/ngB
FBN Finance Company B.V.		
Subordinated		
Foreign Currency	CCC/Watch Neg	B-
First Bank of Nigeria Ltd.		
Counterparty Credit Rating		
Foreign and Local Currency	B-/Watch Neg/C	B+/Negative/B
Nigeria National Scale	ngBB/Watch Neg/ngB	ngA-/--/ngA-2
Subordinated		
Foreign Currency	CCC/Watch Neg	B-

Regulatory Disclosures

- Primary credit analyst: Samira Mensah, Associate Director
- Rating committee chairperson: Mohamed Damak
- Date initial rating assigned: June 11, 2013
- Date of previous review: March 24, 2016

Disclaimers

This rating has been determined by a rating committee based solely on the committee's independent evaluation of the credit risks and merits of the issuer or issue being rated in accordance with S&P Global Ratings published criteria and no part of this rating was influenced by any other business activities of S&P Global Ratings.

This credit rating is solicited. The rated entity did participate in the credit rating process. S&P Global Ratings did have access to the accounts, financial records and other relevant internal, non-public documents of the rated entity or a related third party. S&P Global Ratings has used information from sources believed to be reliable but does not guarantee the accuracy, adequacy, or completeness of any information used.

Glossary

- Adjusted assets: Total assets less nonservicing intangibles.
- Adjusted common equity: Common shareholders' equity plus minority interest, minus dividends (not yet distributed), minus revaluation reserves, minus nonservicing intangibles, minus interest only strips, minus tax-loss carryforwards, minus postretirement benefit adjustments.
- Anchor: The starting point for assigning a bank a long-term rating, based on economic and industry risk.
- Asset-liability mismatch: Occurs when financial terms of an institution's assets and liabilities do not correspond.
- Asset quality: A key measure of the quality and performance of the assets of a bank.
- Available stable funding: Core deposits, plus deposits due to banks (net of those that mature within one year), plus other borrowings (net of maturities within one year), plus total equity, minus intangibles.
- Broad liquid assets: cash (net of restricted cash) and reserves at central bank, plus other cash and money market, plus bank loans and reverse repos that mature in less than one year, plus total liquid assets.
- Business position: A measure of the strength of a bank's business operations.
- Capital and earnings: A measure of a bank's ability to absorb losses.
- Core deposits: Total deposits minus noncore deposits (such as deposits due to banks and certificates of deposits).
- Core earnings over average managed assets: Annualized core earnings, over average assets of current period and last fiscal year.
- Core earnings: Net income before minority interest, minus nonrecurring income, plus nonrecurring expenses, plus/minus tax impact on adjustments, plus amortization/impairment of goodwill/intangibles, minus preferred dividends.
- Cost of funds: Interest expense as a percentage of average interest-bearing liabilities.
- Counterparty credit rating: A form of issuer credit rating, which is a forward-looking opinion about an obligor's overall creditworthiness.
- Credit losses: Losses arising from credit risk.
- Credit risk: Risk that a borrower will default on its payment obligations.
- Customer loans (gross): Total customer loans before loan loss reserves.
- Customer loans (net) over customer deposits: Gross customer loans net of loan loss reserves, over core deposits.
- Date initial rating assigned: The date S&P Global Ratings assigned the long-term foreign currency issuer credit rating on the entity.
- Date of previous review: The date S&P Global Ratings last reviewed the credit rating on the entity.
- Earning capacity: The capacity of a bank to generate sufficient earnings against losses and the primary way that a bank builds or maintains its capitalization.
- Earnings buffer: A measure of the capacity for earnings to absorb normalized losses through the credit cycle.
- Fee income over operating revenues: Net income on fees and commissions over operating revenues.
- Funding and liquidity: A combined assessment of the strength and stability of a bank's funding mix and its ability to manage its liquidity needs in adverse market and economic conditions over an extended period.

- Funding base: Total deposits, plus acceptances, repurchase agreements, and other borrowings (including commercial papers, short- and long-term debt, subordinated debt, and minimal equity content hybrids).
- Government-related entity (GRE) support: An assessment of the likelihood that the government would provide extraordinary support to a bank that is a government-related entity.
- Gross nonperforming assets over customer loans plus other real estate owned over customer loans: Nonaccrual loans, plus restructured loans, plus repossessed assets plus loans 90-days past due; over gross customer loans plus repossessed assets.
- Group support: An assessment of the likelihood that a parent or other group member would provide extraordinary support to a bank within that group.
- Loan loss reserves over gross nonperforming assets: General plus specific reserves, over adjusted nonperforming assets (nonaccrual loans plus restructured loans plus repossessed assets plus 90-day past due loans).
- Long term funding ratio: Available stable funding, over funding base plus total equity, minus intangibles.
- National scale rating: An opinion of an obligor's creditworthiness or overall capacity to meet specific financial obligations, relative to other issuers and issues in a given country or region.
- Net charge-offs over average customer loans: Gross charge-offs net of recoveries, over average gross customer loans of current period and last fiscal year.
- Net interest income over operating revenues: Net interest income (including net interest income on loans, securities, and other assets), over operating revenues.
- New loan loss provisions over average customer loans: Credit loss provisions (including specific loan provisions and general and other provisions) minus recoveries, over average gross customer loans of current period and last fiscal year.
- Noninterest expenses: Salaries and general administrative expenses (including depreciations and amortizations).
- Normalized credit losses: An assessment of the long-term annualized credit-related losses expected through the credit cycle.
- Operating revenues: Net interest income, plus operating non-interest income (that mainly includes fees and commissions and trading gains).
- Preprovision operating income over average assets: Operating revenues minus noninterest expenses, over average assets.
- Return on equity: Net income before extraordinary results minus preferred dividends over average common (average between current period and last fiscal period).
- Risk position: Our view of the specific risk characteristics of a particular bank.
- Risk-adjusted capital (RAC) ratio before diversification: This is calculated according to S&P Global Ratings' methodology as total adjusted capital over risk-adjusted assets.
- Short-term wholesale funding: Debt securities that mature in less than one year (of commercial papers, debt and senior and subordinated bonds), plus bank deposits that mature in less than one year.
- Sovereign support: An assessment of the likelihood that the government would provide extraordinary support to a bank.
- Stable funding needs: Restricted cash and reserves at the central bank, plus interbank deposits, plus loans to banks (net of maturities within one year), plus reverse repurchase agreements, plus gross customer loans net of loan-loss

reserves, plus securities, minus total liquid securities, plus equity participations in nonfinancial entities, plus fixed assets, plus other assets (considering foreclosed assets, tax loss carryforwards, and deferred assets).

- Stable funding ratio: Available stable funding over stable funding needs.
- Stand-alone credit profile (SACP): An interim step in assessing a bank's overall creditworthiness. It includes government support, but not extraordinary government support.
- Total adjusted capital: adjusted common equity plus admissible preferred instruments and hybrids.
- Total wholesale funding: Noncore deposits, plus acceptances, repurchase agreements, other borrowings (including commercial papers, debt and senior and subordinated bonds, minimal equity content hybrids), and total equity, minus minority interest and common shareholders' equity.

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