FDC Economic Bulletin

May 05, 2021

Polaris Bank: Sustained performance in a Challenged environment

Intrinsic Valuation exceeds Financial Value

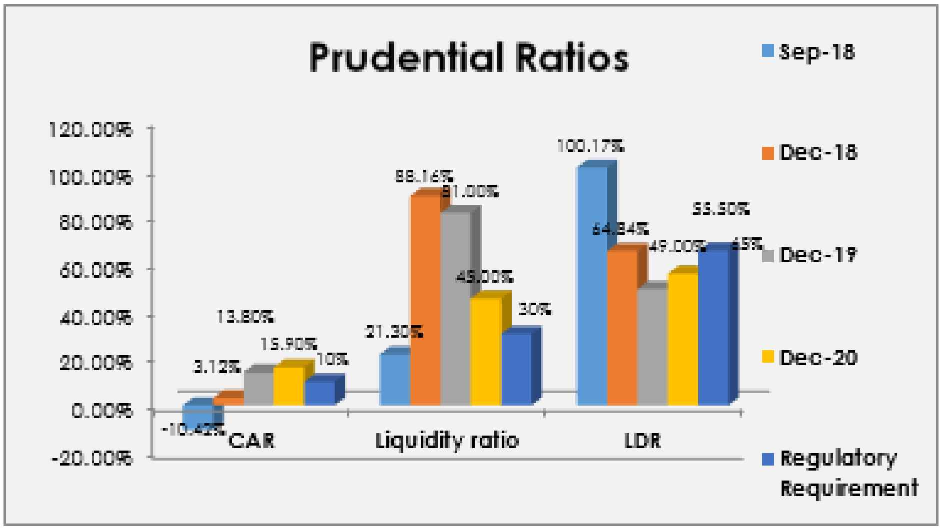
Background

After being left for dead by the markets just a few years ago, Polaris Bank, the resurrected offspring of Skye Bank, surprised the market with stable earnings in a challenged, pandemic-ridden business environment. Its gross revenue fell by 14% to N129.31bn but its profit before tax (PBT) grew by 4% to N28.9bn and the balance sheet footing now stands at N1.18trn – a growth rate of 3%. All of these significant events happened at a time when the bank's activity was restrained by the regulator. It is astonishing that the bank's liquidity ratio (45%) and diversity of its purchased funds makes it more resilient from liquidity shocks and helps it provide a shield for its solvency shortfall.

This analysis is in the context of a year in which Nigeria's GDP growth came in at (-1.92%) and the financial services sector delivered a growth of 9.37%. The real question is how did this bank, handicapped by a regulator breathing down its neck and competition eating its lunch, survive and thrive in an economically cloudy space?

Seamless Transition at the Top

As if the exogenous challenges were not debilitating enough, the bank had to manage a change in the baton of leadership from its erstwhile CEO, now serving as Senator of Lagos (Lagos East Senatorial district) to another veteran of the GTBank School of Institutional Building. The bank is under the stewardship of a seasoned banker who had spent significant stints in two of the most successful banks in Nigeria – Access and GT. The market perceives Innocent Ike as a safe pair of hands. His ability to manage the compressed margins associated with the artificially low interest rates and to leverage the excess liquidity into a source of competitive advantage is legendary. The bank's liquidity ratio is 45% as against the statutory ratio of 30%. Its net interest margin has declined only marginally (by 2%) in this difficult and aberrational interest rate environment. Polaris has been able to exploit the market inefficiencies and gaps to boost its earnings and interest rate spread simultaneously.



The bank's leadership team under the unassuming Innocent Ike at the helm is well positioned to navigate the bank in the current climate of regulatory ambiguity and unpredictability in which capital markets are volatile and an accelerating global post pandemic economic recovery.

Nothing demonstrates this better than the quality of Polaris earnings. While its NPL ratios increased slightly to 49.9% from 46% in 2019, its impairments have shrunk by 33% to N9.39bn compared to an industry average of N10bn (Tier-2 banks), which is mostly papered over by financial balance sheet cosmetics.

Stiff Competition in an evolving landscape

The banking industry is grappling with competitive rivalry within the industry as hungry players like Access, Zenith and GT are adopting ruthless strategies to expand market share domestically and across Africa, on the one hand, whilst simultaneously defending itself from cannibalistic competitor moves by the Telco's and their surrogates – the Fintechs.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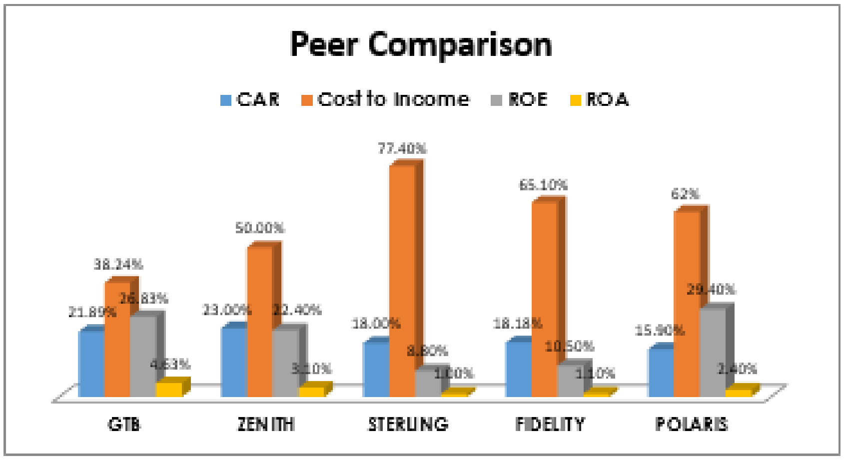

The evidence from NIBSS data is showing that the payment system has moved almost by 80% to electronic and digital payments. In Q1'21, the ratio of electronic payments to cheques rose to 78:1 from 33:1 in Q1'20. The payment and settlement system has now become a high volume thin margin business. Nothing demonstrates this better than the economic spats between MTN and the money deposit banks on the commission on recharging airtime via the banking system. MTN was alleged to unilaterally cut the discount due to the banks and contractors. The banks responded viciously, until a temporary amicable solution was reached.

What is clear is that MTN was making a well formulated strategic move and the banks were responding tactically. In the final analysis, the banking system will come to terms with their declining leverage as a function of time. Earlier, the USSD termination charge of N6.98 and the arrears to be spread over a number of years was a sign of a changing or deteriorating bargaining position of commercial banking in Nigeria.

That is why the digital investment strategy of Polaris first under Tokunbo Abiru and continued by Innocent Ike could not have been made at a better time. Digital banking is not leveraged by traditional metrics of capital adequacy, net worth and loans to deposit ratios but by the nimbleness of the franchise and its ability to build on its intrinsic value and brand equity. This is where the Polaris, Wema, UBA, GTbank etc are moving exponentially in the wooing of the generation Z who do not care about balance sheet size and number of branches.

Positioned for Growth and Resilience

Finally, we notice that Polaris' cost to income ratio went up by 5% to 62% – higher than the industry average of 56.3% (Tier-1 Banks). Our view is that if anything is going to differentiate Nigerian banks in 2022/23, it is cost containment and digital efficiency. This is where Polaris, in spite of its legacy problems, has a source of competitive advantage. The sale of the franchise by AMCON should position it for accelerated growth as long as the regulator can offer the potential investors a carry that makes the investment worthwhile. We are optimistic and confident that the story of Polaris bank's recovery is just beginning.