The Essence of Bank Recapitalisation:

Understanding the fundamentals and the technicalities of investment in shares

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Introduction

- Definition and objectives of recapitalisation
- Historical context of Bank recapitalisation across the globe
- Cases of recapitalisation and their common theme
- Role of recapitalisation in Business and the Economy
- Common recapitalisation Methods

Bank recapitalisation - a critical process aimed at strengthening financial stability and operational capacity of banks.

Bank recapitalisation usually involves raising additional capital to **support the operations**, **enhance resilience against economic shocks**, and **fulfil regulatory capital requirements**.

Objectives of recapitalisation with practical examples

- Strengthening financial stability and supporting economic growth: Bank of America Recapitalisation (2008–2009)
- Complying with regulatory capital requirements and maintaining market confidence: Citigroup recapitalisation (2008–2009), Nigerian Banking N25 billion capitalisation (2004 -2005)
- Facilitate merger and acquisitions: Lloyds TSB 2008 acquisition of Halifax Bank of Scotland (HBOS), Access Bank acquisition of Diamond Bank (2018)
- Enhancing lending capacity, maintaining liquidity and reducing insolvency risks: ECB Targeted Longer-Term Refinancing Operations (TLTRO)

Historical context of bank recapitalisation

The great depression (1929 – 1939)

Major cause were the **stock market crash of 1929, bank failures, and a drought**. In the aftermath, many banks faced insolvency due to widespread loan defaults and economic collapse. Governments around the world implemented programs to recapitalize banks and restore confidence in the financial system.

Post-World War II Recession (1948 – 1949)

One of the main reasons for the Post-War Recession was the transition from a wartime to a peacetime economy. Several countries experienced economic reconstruction and development, leading to a need for **increased bank capital to support growth**. Governments and central banks played a crucial role in providing capital to banks and fostering economic recovery.

Financial crises of the 1980s and 1990s

The savings and loans crisis in the United States caused by the tightening of monetary policies and the Asian financial crisis of the late 1990s caused by the collapse of the currency exchange rate and hot money bubble highlighted the importance of bank capital in preventing systemic financial instability. Governments and international financial institutions implemented recapitalization measures to stabilize the banking systems in affected countries.

Global financial crisis of 2008

Significant decline in bank capital as many institutions suffered losses due to the collapse of the housing market and the credit bubble. Governments around the world provided unprecedented levels of capital to banks to prevent a systemic collapse of the financial system.

Cases of recapitalization and their common theme

United States: The Troubled Asset Relief Program (TARP)

China: Bank Recapitalization and Asset Management Companies

Ghana: Bank Recapitalization and Consolidation

European Union: Bank Recapitalization Initiatives

India: Recapitalization of Public Sector Banks

Kenya: Recapitalization of Commercial Banks

- Regulatory Compliance
- Financial Crisis Response
- Strengthening Balance Sheets
- Supporting Economic Growth
- Mergers and Acquisitions
- Government Intervention
- Risk Management Improvements
- Asset Quality Improvement
- Investor Confidence Restoration

Essentially, the role of recapitalisation in navigating economic and business uncertainties is critical

- **Regulatory compliance**
  - Meeting capital adequacy requirements
  - Addressing regulatory concerns
- **Financial stability and resilience**
  - Strengthening balance sheet
  - Improving creditworthiness
- **Strategic objectives**
  - Funding expansion plans
  - Resolving financial difficulties
  - Preparing for future challenges e.g innovation
- **Investor relations**
  - Attracting new investors
  - Reassuring existing investors

Nevertheless, recapitalization is a complex process with potential risks and benefits.

Some approaches to recapitalisation

Equity capital

Banks can raise capital through private placements, IPOs, offer for subscription and rights issue.

Government bailouts

Banks could get a direct aid from the government. Cash injection (Debt/Equity), An instance was the establishment of AMCON in 2010 to aid the recovery of bad loans, thereby strengthening financial system stability

Mergers and acquisition

Banks could come together and consolidate in M&A to strengthen their capital base.

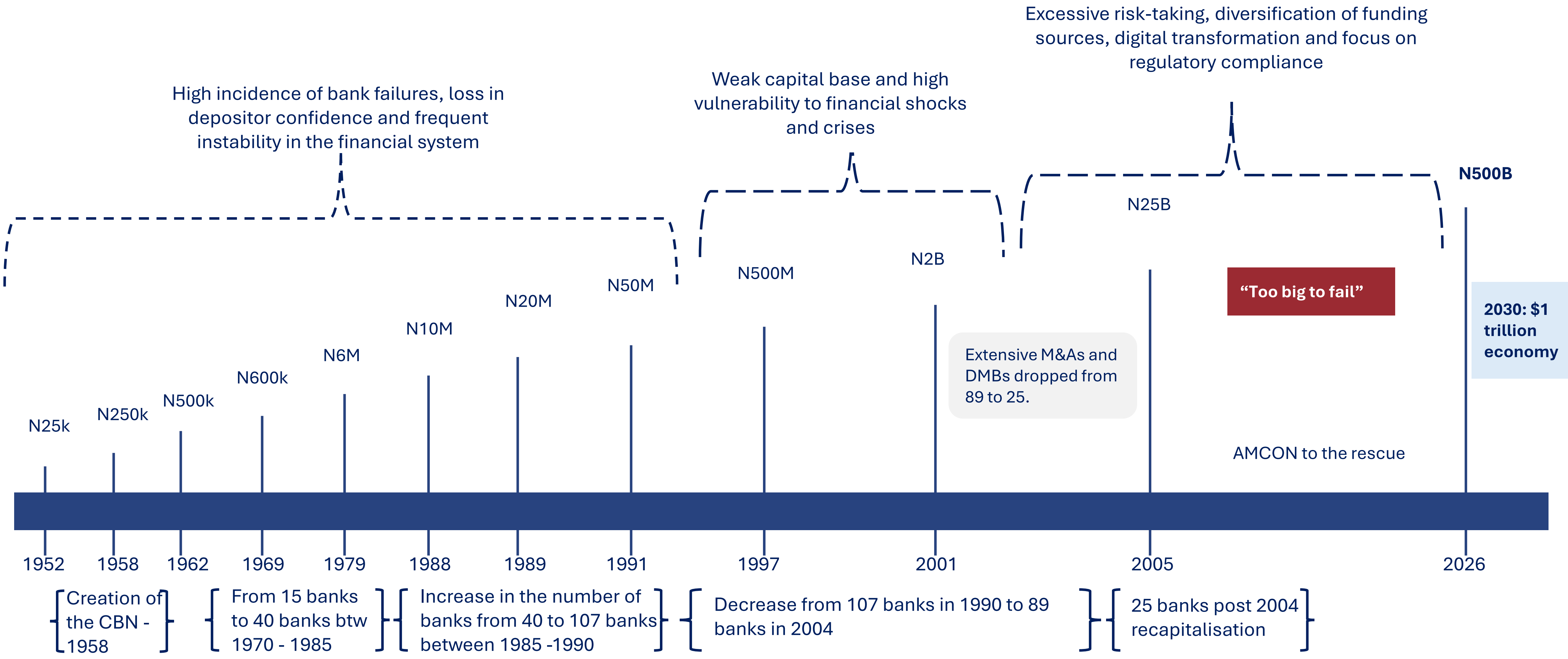
License upgrade or downgrade

In the case of a last resort, banks could choose to downgrade their license if unable to meet up with the new capital requirements or vice versa.

The Nigerian context

- Evolution and structure of Bank recapitalisation in Nigeria
- 2024: CBN recapitalisation requirement for Nigerian banks
- Some Banks’ current position
- Options available for Nigerian banks
- Impacts of recapitalisation on financial stability efforts in Nigeria

Evolution and structure of Bank recapitalisation in Nigeria



Source: *IRDI, International research and development institute.*

2024: CBN recapitalisation requirement for Nigerian banks

Category	License	2005 Capital requirement (₦'Bn)	2010 requirement (₦'Bn)	2024 Capital requirement (₦'Bn)	(% change) 2010-2024
Commercial	International	25.0	50.0	500.0	900.0%
	National	25.0	25.0	200.0	700.0%
	Regional	25.0	10.0	50.0	400.0%
Merchant	National		15.0	50.0	233.3%
Non-interest	National		10.0	20.0	100.0%
	Regional		5.0	10.0	100.0%

Source: *KPMG Flashnotes, April 2024.*

Some Banks' current position

	Capital position	Additional capital	CBN minimum requirements
access	251.81	248.19	500
FBNHoldings	251.34	248.66	500
UBA	115.82	384.18	500
GTCO Guaranty Trust Bank Ltd	138.19	361.81	500
ZENITH	270.75	229.25	500
FCMB	125.29	374.71	500
Fidelity	129.71	370.29	500

Source: *Banks Full year 2023 audited FS.*

The options available to Nigerian banks…

Rights issue	In 2014, Access bank put out a rights issue of 7.6b ordinary shares, worth over ₦3.8b at ₦6.90 per share. This enabled the bank pursue its expansion strategy.
Private placement	Banks can issue stocks to pre-selected investors/institutions rather than as a public offering
Initial public offering	Companies like Standard Trust bank issued an IPO in 2004, although was subsequently merged with UBA in 2009.
Offer for subscription	See some recently released offer prospectus such as; Zenith Bank Plc, Offer for subscription (2024). GTCO, offer for subscription (2024).
Mergers & Acquisition	First Bank of Nigeria – First Bank, MBC int'l bank and FBN Merchant Bankers (2005) Wema Bank – Wema bank, National Bank of Nigeria ltd (2005) Access Bank Plc – Access bank, Marina Int'l bank and Capital bank Int'l (2005); then with Diamond Bank
License upgrade or downgrade	Recent merger between Providus bank (regional license) and unity bank (national license) has automatically upgraded the license of Providus bank to a national license if new capital requirements are met within the deadline.

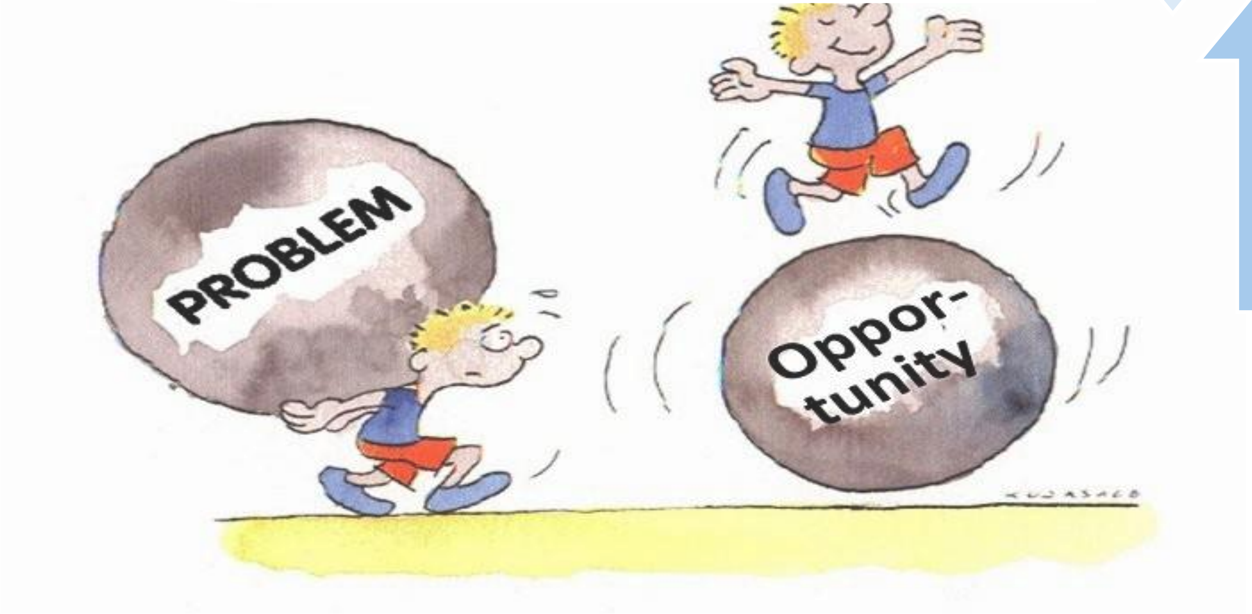
Impacts of recapitalization on financial stability efforts in Nigeria

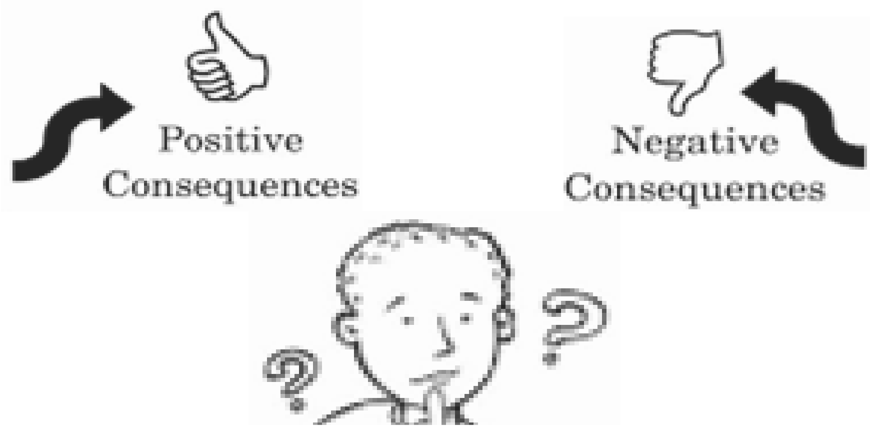
Opportunities

- Digital Transformation
- Financial inclusion initiative
- A growing demand for diversified financial services

Challenges

- Economic volatility
- Regulatory compliance cost
- High non-performing loans





Positive impact

- Improved creditworthiness
- Enhanced financial stability
- Strengthened financial system

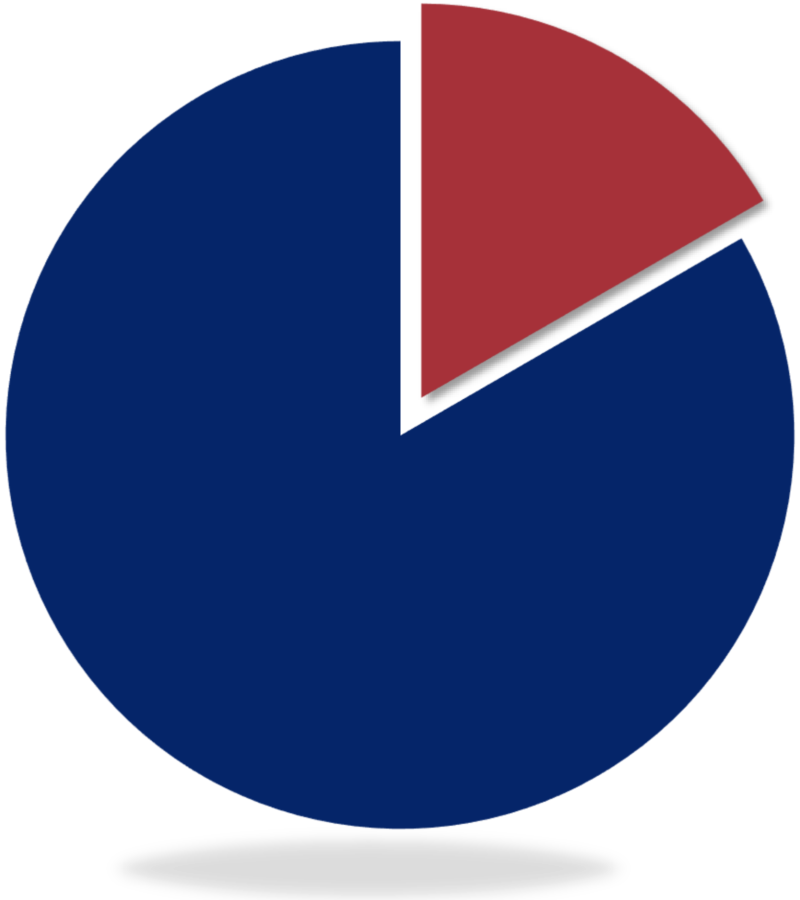
Negative impact

- Increased costs arising from raising new equity or restructuring debt
- Reduced efficiency
- Moral hazard

Investing in Banking Stocks

- Why invest in bank shares?
- Common strategies of investment
- Factors affecting bank share prices
- Post recapitalisation considerations for potential investors
- Balancing risk and return in bank shares post-CBN minimum capital requirements

Why invest in bank shares?



Stability and resilience

Banks are heavily regulated, providing a strong level of stability, reducing risk exposures compared to less regulated sectors. Also, banks provide essential services which culminates to consistent demand even during economic downturns.

Capital accretion

Strong performance and favorable economic conditions elevates share prices, providing substantial returns and benefit from capital gains. Furthermore, investors can participate in earnings growth and corporate decisions through share ownership

Dividend income

Consistent dividend payments serves as a reliable source of income for investors, company growth may result in increased dividend payout, enhancing income potential.

Liquidity

Bank shares are highly liquid, meaning they can easily be bought or sold on the stock market.

Factors affecting bank share prices

Economic factors	Higher **Interest Rates** typically boost profitability and positively affect share prices	**GDP expansion** generally leads to higher lending demand, lower default rates, and increased bank profitability, which positively impacts bank share prices.	A sustained uptick in **Inflation Rate** directly affects demand deposits and value of loans impacting on profitability.
Regulatory environment	Major **Government Policies** shift can impact the operating environment and impact share prices.	**CBN Regulations** play a crucial role in dictating investors' sentiments leading to a potential decline in share prices	In line with the new **minimum capital requirements** to sustain a trillion-dollar economy, investors have shown positive sentiments and expectations on how this translates to a developed economy.
Industry competition	A larger or growing **market share/size** generally leads to economies of scale and a stronger competitive position.	Banks that offer **innovative products** and services gain competitive advantage, attracting new customers and additional revenue.	Retaining and improving **customer satisfaction** and confidence is crucial in maintaining a sustainable income flow.
Bank-specific factors	**Performance/strategic outlook –** the strength of results delivered by a bank engenders market confidence and attract investors leading to increased demand for the stock	A stable bank with **stable earnings**, **dividends payout or growth**, could be an appealing target for investors, potentially improving share price.	Sustainable core earnings depends largely on the **quality of risk assets**. A consistent decline in asset quality could potentially impact negatively on share prices

Common strategies of investment

Growth investing

- **Identify banks with strong growth prospects** like profitable expansion, increasing market share, innovative products.
- **Banks in emerging markets** with growth potential.
- **Earnings per share**: A growing EPS connotes healthy bank profits.

Value Investing

- **Undervalued banks** with stock prices trading below intrinsic value.
- **Key financial metrics** like the price-to-earnings ratio (P/E), return on equity (ROE) compared to industry average.
- **Banks facing temporary challenges**: At times, banks may be undervalued due to short-term issues that are expected to be resolved imminently.

Dividend investing

- **Focus on dividend-paying banks**
- **Consider dividend growth**: consistent record of increasing dividend payout over time.
- **Dividend investment**: Reinvest dividends to compound your returns.

Cost averaging (CA)

- **Invest a fixed amount regularly**: Regardless of the stock price, invest the same amount at regular intervals.
- **Smoothing out volatility**: CA helps to average out the cost of your investment over time

Considerations for potential investors in banking stocks

Capital Adequacy

Assess bank's capital adequacy ratio to ensure it **meets** regulatory requirements and has sufficient capital to absorb losses.

Asset quality

Adequate evaluation of the quality of risk assets portfolio and exposure to non-performing loans.

Earnings quality

Governance/Management

Assess the bank's corporate governance practices, including the independence of its board of directors and the strength/experience of management

Liquidity

Ensure the bank has sufficient liquidity to meet its obligations and withstand market shocks.

Balancing risk and return in bank shares

The review of minimum capital requirements by the Central Bank of Nigeria (CBN) has significantly reshaped the banking landscape in Nigeria. These requirements aim to enhance the stability and resilience of the banking system, but this also introduces new considerations for investors. Balancing risk and return in bank shares becomes even more critical.

Quality analysis

Focus should be placed on banks with strong financial performance, effective management, and a solid track record of compliance with regulatory requirements.

Relative valuations

Consideration could be given to the risk profile of each bank and valuations adjusted accordingly. Banks with higher risk profiles may require a lower valuation to compensate for the increased risk.

Dividend yield

Banks with a strong dividend yield can provide a steady income stream, even in periods of market volatility.

Investment Horizon

Investing in bank shares could be a long-term strategy, towards benefiting from the growth potential of the banking sector.

Diversification

Investing in a diversified portfolio of bank shares can help reduce risk by spreading it across different institutions.

Case studies

- Nigeria's 2004 Banking Sector Recapitalisation
- Lloyds Banking Group Recapitalisation (2009–2014)
- Citigroup Reaction to 2008- 2009 financial crisis
- Case Studies on the Technicality of Investment in Shares
- Summary of Investor Reactions to Recapitalisation

Nigeria's banking sector recapitalisation

2004

Drivers
Weakening financial system
Need for consolidation
Enhancing international competitiveness

Approach
Rights Issues
IPOs/POs
Private Placements
Mergers & Acquisitions

Outcomes
Banks reduced from 89 to 25
Larger banks with bigger finance capacity
Global presence

2008

Drivers
Rescue 8 distressed banks
Stabilizing the financial system

Approach
Establishment of AMCON
Purchase of NPLs by AMCON

Outcomes
Stronger regulations
Improved corporate governance
Financial system stability

2010

Drivers
Need for financial system stability
declining corporate governance
Increasing systemic risk.

Approach
Phasing out universal banking
Introduction of financial holding companies

Outcomes
Enhanced Regulatory Oversight
Business Diversification
International Expansion
3 HOLDCOs
Capital efficiency

Post 2010

Drivers
Financial stress of some banks
Ambitious banking strategy
International expansion

Approach
All-Share Transaction
Regulatory induced acquisitions

Outcomes
Increased Competition
Reinforced consolidation trend
Increased financial inclusion

Lloyds Banking Group recapitalisation (2009–2014)

A prime example of how equity recapitalization, though initially challenging, can have a positive long-term impact on stock price performance

LLOYDS BANKING GROUP

Problem Faced

Intense pressure to meet regulatory capital requirements due to impact of the 2008 global financial crisis coupled with exposure to substantial losses and declining capital base after the acquisition of HBOS.

Solution Offered

Raised £13.5 billion equity in Rights Issue offering at a discounted price to strengthen capital base, repay some of government's bailout, and restore investor confidence.

Immediate Reaction to Recapitalization was Negative

Investors were cautious about the short-term outlook, given the scale of the capital raise and the existing losses on balance sheet due to inherited toxic assets

The Benefits

- Strengthened Financials
- Return to Profitability (2012–2014)
- Stock price recovery and positive performance
- Investor Confidence Restored
- Dividend restoration in 2014

The recapitalisation of Citigroup during the 2008-2009 financial crisis

The recapitalisation of Citigroup during the 2008-2009 financial crisis is a significant case study

Background: Citigroup, formed from the merger of Travelers Group and Citicorp in 1998, was a major global financial institution. By 2006, it had a market capitalisation of $274 billion.

Crisis Impact: The financial crisis severely impacted Citigroup, leading to massive losses. By 2009, the firm had lost over $250 billion in value and was worth less than $16 billion.

Government Intervention: In response to the crisis, the U.S. government intervened, converting billions of dollars in bailout money into a 34% ownership stake in Citigroup. This effectively nationalised the firm to stabilize it.

Strategic challenge: Citigroup's high-risk, high-growth strategy during the 2000s led to significant losses, with over $130 billion lost on loans and investments from 2007 to 2009.

Recovery Efforts: To repay the $20 billion of TARP funds, Citigroup sold more common stock in December 2009, which diluted the taxpayer's stake.

This case highlights the importance of risk management, regulatory oversight, and strategic decision-making in the financial industry

Case studies on the technicality of investment in shares

Cases	Investment Strategy	Technicalities	Success/Failure
Warren Buffett and Berkshire Hathaway: Buffett's investment strategy has yielded impressive returns over decades, making him one of the most successful investors of all time.	One of the most famous examples of successful investing in shares is Warren Buffett and his company, Berkshire Hathaway. Warren Buffett is renowned for his value investing approach, **focusing on undervalued companies with strong fundamentals and holding them for the long term**. He often invests in companies with durable competitive advantages and consistent cash flow.	Buffett's approach often involves **analyzing a company's financial statements, understanding its business model**, and assessing its competitive advantage. He also places a strong emphasis on corporate governance and management quality. While Buffett primarily relies on fundamental analysis, he does consider technical factors like price charts and trading volume to identify potential entry and exit points.	Buffett's investment in Coca-Cola is a classic example of his value investing strategy. He identified Coca-Cola as a company with a strong brand, consistent cash flow, and a moat (competitive advantage).
The Dot-com Bubble and Subsequent Bust	The late 1990s saw a surge in investment in technology companies, leading to the dot-com bubble. Many investors became **overly optimistic about the prospects of these companies**, driving up their stock prices to unsustainable levels.	The dot-com bubble **was fueled by speculation and a lack of due diligence**. Many **investors failed to properly assess the fundamentals of these companies**, and the risks associated with investing in such a rapidly growing sector	The bubble eventually burst, leading to significant losses for many investors. This case study highlights the importance of careful analysis and risk management in investing.

Source: Wikipedia, Investopedia.

Summary of investor reactions to recapitalisation

Sometimes, the market could have an initial negative reaction to Bank recapitalisation.

Reactive recapitalisation in response to a financial crisis: Deutsche Bank (2017). Stocks dropped significantly before the announcement, as investors feared dilution. The stock rebounded slightly after the bank stabilized.

Market timing as recapitalisation may signal distress: Citigroup (2009). Stock fell sharply during the recapitalization but eventually recovered as the bank's financial condition improved.

However, if investors see the recapitalisation as a way to enhance long-term growth and profitability (e.g., expanding lending capacity, reducing debt), they tend to view the news positively.

Conclusion

By carefully considering these technical factors, investors can make informed decisions about investing in shares during bank recapitalisation.

These case studies illustrate the technical challenges and opportunities associated with investing in bank shares during recapitalisation processes. **Investors should carefully consider the specific circumstances of each bank and the broader economic environment before making investment decisions.**

Financial Health: Investors should carefully assess the financial health of banks, including their capital adequacy ratios, profitability, and asset quality etc.

Governance and Management: Good corporate governance and strong management teams are essential for the success of banks.

Regulatory Environment: Consider the regulatory environment in which banks operate, including the impact of government policies and regulation.

Government Support: Consider the level of government support for the bank, as this can influence its stability and prospects.

Economic Outlook: Evaluate the broader economic conditions and their potential impact on the bank's performance.

Risk Tolerance: Assess your own risk tolerance and investment goals to determine if investing aligns with your financial objectives.

Valuation: Investors should use appropriate valuation methods to determine the fair value of bank shares and assess whether they are undervalued or overvalued.

Thank You!

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