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SSA Banks

Kenya and Nigeria – the best of both markets

Sector insight

Equity Research | Banks

- **We set out a performance league table for our SSA banks coverage, with a focus on the top five banks in Kenya and Nigeria. We have evaluated profitability, efficiency and market dominance. We also describe our selection criteria for each market following the release of their FY17 audited results. Nigerian banks (GTB and Zenith) outperform on ROE ranking, Kenyan banks outperform on efficiencies, while market share dominance (based on assets, loans and deposits) for the top five banks in relatively similar. The results reiterate our top picks within the two markets (GTB, Zenith, Equity and KCB) with a preference for Nigerian banks over Kenyan banks for now as we wait for a review of the interest rate cap in Kenya.**

- **GTB, Zenith, Equity and KCB top our coverage based on ROEs**. We believe that the higher interest rate environment in Nigeria and derivative gains have been key drivers of profitability in the country. Within our coverage, Guaranty Trust Bank (GTB) outperforms on both ROE and ROA. For Kenya, we attribute the lower ROE profile to NIM compression from 2016 as a result of interest rate caps introduced in September 2016.

- **Top five banks dominate above 50% market share in assets, loans and deposits.** Our analysis shows that the Kenyan and Nigerian banking sectors are reasonably concentrated with the top five banks in both markets accounting for c.65% and 53% of sector assets respectively (2017 latest available figures). Furthermore, the top five Nigerian banks dominate in loans and deposits (60% deposits, 58% loans) market share, far more than the Kenyan banks (54% deposits, 55% loans). In Nigeria, Zenith Bank dominates with a market share of 17%, while KCB is the dominant bank in Kenya with a market share of 16%. Within the top five, GTB has the lowest market share in Nigeria at 10% while BBK has the lowest in Kenya at 7%.

- **On average Kenyan banks have been more efficient than Nigerian banks.** GTB, Zenith and DTB are top in efficiency with cost-to-income ratios of 36%, 43% and 43% respectively. On a regional basis, the Kenyan banks had a lower cost-to-income ratio at 50.7% vs. 51.3% for the Nigerian banks in 2017. On a company level, however, the differences are quite notable. GTB is the most efficient bank in our coverage with an average (FY15 - FY17) cost-to-income ratio of 38% followed by DTB with an average of 41%. We note that for both banks staff costs contributed less than 40% of total costs in FY17.

- **Rate caps crimp Kenyan banks' NIMs.** The interest rate cap continues to limit NIMs for the Kenyan banks where NIMs have declined by 100 bps since 2015 down to 8.35% for our top five banks. In contrast, Nigerian banks' average NIMs improved from 7.41% in 2015 to 8.54% in 2017. Nigeria's GTB Bank leads our ranking table with a NIM of 11.6% for FY17 while Access lags the group with a NIM of 5.8%. We believe that any rate cap reform that supports SME credit extension will be materially positive for our coverage names in Kenya.

- **Our top picks remain unchanged; GTB and Zenith in Nigeria, Equity and KCB in Kenya.** We continue to prefer **GTB (BUY TP N57)** based on the bank's sustainable efficiency model and growth in customers, which we expect to drive sustainable customer business in 2018e. Among the Kenyan banks we prefer **Equity (BUY TP Ksh54)** due to its relatively superior earnings growth profile over the next 2 years driven by renewed credit appetite supported by improved business sentiment.

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Executive summary

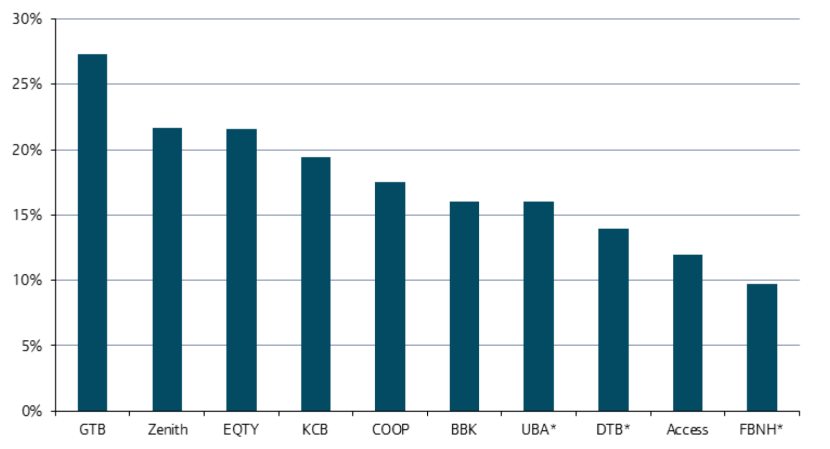
We set out a performance league table for our SSA banks coverage with a focus on the top five banks in Kenya and Nigeria. We have evaluated profitability, efficiency and market dominance. We also describe our selection criteria for each market following the release of their FY17 audited results.

We arrived at our top five ranking based on market share of total assets. We also compare dynamics such as concentration, balance sheet structure and margins. While we wait for audited full-year results for UBA, FBNH and DTB, we apply their 9M:17 results for our analysis.

GTB, Zenith and Equity lead on ROE

GTB, Zenith and Equity top our coverage based on ROE, even though the Kenyan banks are more profitable on aggregate, with average ROE of 17.7% vs. 17.3% for the Nigerian banks. We believe that the higher interest rate environment in Nigeria and derivative gains have been key drivers of profitability. We attribute the Kenyan banks' lower ROE profile to NIM compression from 2016 as a result of interest rate caps introduced in September 2016. Deteriorating asset quality resulting in higher loan loss provisions has been responsible for the weak ROE in FBNH and Access Bank.

Figure 1: ROE ranking



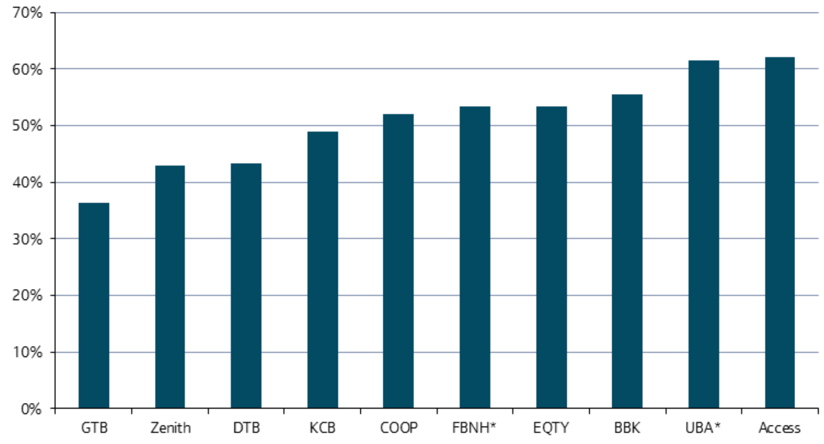
Source: Company financials, SBGS analysis,* 9M 17 figures

On average Kenyan banks have been more efficient than Nigerian banks

GTB, Zenith and DTB have outperformed in efficiency, with cost-to-income ratios of 36%, 43% and 43% respectively. On a regional basis, the Kenyan banks had a lower cost-to-income ratio at 50.7% vs. 51.3% for the Nigerian banks in 2017. Over the past three years, operating efficiency of the Kenyan banks has been higher at 50% vs. 53% for Nigerian banks.

However, our analysis on total cost and revenue per employee across our 10 names, shows that Nigerian banks have much higher net revenue per employee (revenue per employee *less* cost per employee). Based on our calculations, Zenith has the highest net revenue per employee ahead of Access and GTB. In the Kenyan market, DTB is ahead of BBK and COOP.

Figure 2: Cost-to-income ratio

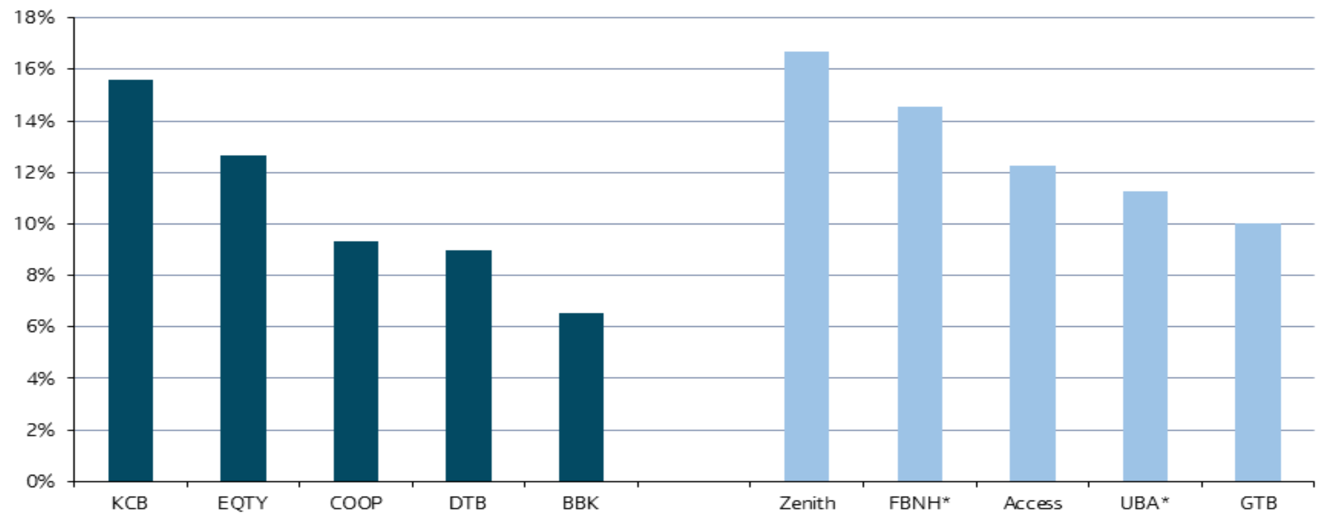


Source: Company financials, SBGS analysis,* 9M 17 figures

Top five banks in both markets account for over 50% of balance sheet

In Nigeria, Zenith Bank dominates with a market share of 17%, while KCB is the dominant bank in Kenya with a market share of 16%. Within the top five, GTB has the lowest market share in Nigeria at 10% while BBK has the lowest in Kenya at 7%.

Figure 3: Total assets market share of Kenyan banks vs Nigerian banks



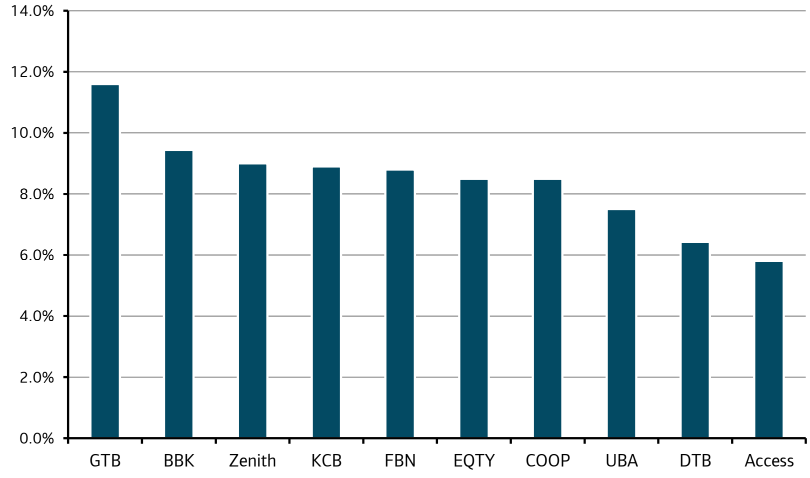
Source: Company financials, SBGS analysis,* 9M 17 figures

The Kenyan and Nigerian banking sectors are reasonably concentrated with the top five banks in both markets accounting for c.65% and 53% of sector assets respectively. The assets of the Kenyan banking sector stood at USD40bn vs. USD101bn for the Nigerian banking sector.

The top five banks account for c.54% of customer deposits in Kenya while the top five banks in Nigeria account for c.60% of deposits. While customer loan market share of the top five Kenyan banks increased slightly to 55% in 2017 from 53% in 2015, the loan market share of the top five banks in Nigeria declined considerably to 58% in 2017 from 65% in 2015. KCB dominates the Kenyan banks on customer loans at c.17% over the past three years, while Zenith Bank has been dominating in the Nigerian banking sector at 13%.

Rate caps crimp Kenyan banks' NIMs

Figure 4: Net-interest margin ranking (2017)



Source: Company financials, SBGS analysis

Nigeria's GTB and Zenith banks' NIMs rank top in our coverage at 11.6% and 9% with KCB at 8.9%. However, we note pre-rate caps, Kenyan banks' NIMs were on average higher than those of Nigerian banks. The interest rate cap continues to limit NIMs for the Kenyan banks where NIMs have declined by 100 bps since 2015 down to 8.35% for our five banks. In contrast, Nigerian banks' average NIMs improved from 7.41% in 2015 to 8.54% in 2017. Nigeria's GTB Bank tops our ranking table with a NIM of 11.6% for FY17 while Access lags the group with a NIM of 5.8%.

Loans and advances interest income remains a key driver of interest income. Nevertheless, it is worth noting that the contribution from investment securities grew in FY17 vs. FY16. In Nigeria, it grew from an average of 25% in FY16a to 30% in FY17 and in Kenya from 25% in FY16a to 27% in FY17a.

Kenyan bank loan yields declined from an average of 14.7% in 2015 to 12.4% in 2017. The three local banks EB, COOP and KCB were the worst hit with loan yields declining by 350, 247 and 210 bps respectively. Post interest rate caps, lending yields are less divergent across the large retail banks ranging between 12.5% and 13.0%. Should interest rate cap reforms be favourable to SME market lending, we expect these three banks to be the main beneficiaries.

Our top picks

We maintain our preference for Nigerian banks over Kenyan banks as we wait for a review of the current interest rate cap.

Among the Nigerian banks, **GTB (BUY; TP: N57)** is our top pick based on the following;

- We believe that the bank's sustainable efficiency model should keep the cost-to-income ratio low relative to peers.
- The bank continues to improve its retail profile and customer service offerings, resulting in strong customer growth. The bank acquired close to 3 million customers in 2017. We expect this to drive sustainable customer business in 2018.

We also have a preference for **Zenith Bank (BUY; TP: N35)** based on the following

- The bank's operating efficiency is relatively lower than the peer average and has been consistent over the past five years, which should keep profitability relatively higher than peers.
- The bank's asset quality remains relatively better than peers, which has kept cost of risk lower than peers.

Among the Kenyan banks, **Equity (BUY; TP: KSh54)** is our top pick based on the following;

- Its relatively superior earnings growth profile over the next two years driven by renewed credit appetite supported by improved business sentiment. Equity held off loan growth in FY17 in what management termed a high-risk environment. Considering the bank's strong deposit franchise (+1% growth FY17), mostly channelled to government securities, we expect Equity to rotate into customer loans in FY18 - FY19e (18% average) as some risks abate and the expectation of rate cap reforms.
- We expect that Equity's continued investment in alternative channels will continue to support superior non-interest income and improved efficiencies in the medium term.

We also prefer **KCB (BUY TP: KSh55)** based on the following;

- We expect the bank to continue loan growth into FY18 - FY19e as business conditions improve and the expectation of rate cap reforms. Its superior deposit franchise with growth of 11% in FY17a resulted in a cost of funds below 3.0%, well below most of its peers.
- We note improved efficiencies at KCB over the past few years and expect to see the benefits of the recent staff rationalisation programme in 2017 that saw 316 staff released during the year.

Key risks

Nigeria

- Further material reduction in yields could depress NIMs below expectations.
- A slower than expected recovery in the economy could keep credit growth and fee income depressed for longer.
- Higher than expected deterioration in asset quality could elevate credit impairments above expectations.
- Sustainability of non-interest revenues remains a key concern in 2018 as high contribution from derivative and T-bills trading income is questionable over the near term.

Kenya

- Systemic challenges posed by smaller banks struggling to adjust to interest rate caps may still play out.
- Interest rate caps dampen credit growth below our cautious expectations in the short term. Long term, we believe that rate cap reforms could be materially positive for the Kenyan banks.
- System-wide asset quality continues to deteriorate.

Valuation summary

Figure 5: Valuation summary (22 March 2018)

	Share price	Rating	Target Price	Market Cap (USD'm)	FY18E						
Nigerian banks					ROE	EPS	BVPS	DPS	PE	PB	DY
Guaranty Trust Bank PLC	44.95	BUY	57.00	3678	27%	5.96	24.74	2.89	7.5	1.8	6.4%
Zenith Bank Plc	28.8	BUY	35.00	2514	19%	5.16	28.75	2.58	5.6	1.0	9.0%
Access Bank Plc	11.1	BUY	13.71	893	17%	3.08	19.37	0.86	3.6	0.6	7.7%
United Bank for Africa Plc (UBA)	11.75	HOLD	11.36	1117	15%	2.31	17.24	0.92	5.1	0.7	7.9%
FBN Holdings Plc	12.05	HOLD	10.10	1202	12%	2.08	20.29	0.43	5.8	0.6	3.5%
Kenyan Banks											
Equity Group Holdings	53.5	BUY	54	1963	23%	6.13	28.21	2.69	8.6	1.9	5.1%
Kenya Commercial Bank	51.5	BUY	55	1565	21%	7.5	25.78	3.5	6.9	1.4	6.8%
Co-operative Bank of Kenya	19.45	HOLD	18.6	1131	20%	2.13	13.27	0.91	9.1	1.5	4.7%
Barclays Bank of Kenya	12.65	HOLD	11.6	681	19%	1.62	8.9	1.17	7.8	1.4	9.2%
Diamond Trust Bank Kenya	216	SELL	163	518	15%	21.06	214.57	2.29	8	1	1.1%
Kenyan banks average					20%	8.89	60.15	2.11	8.07	1.44	5.4%
Nigerian banks average					18%	22.74	22.74	1.54	5.52	0.89	6.9%

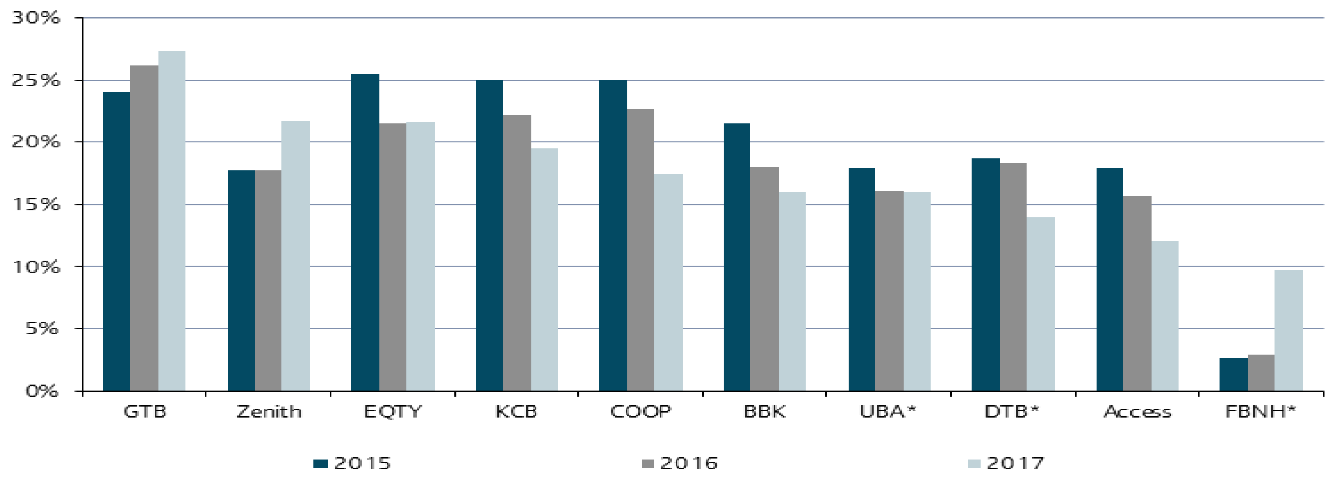
Source: Company financials, SBGS estimates and analysis

Profitability

GTB leads but FBNH lags

Within our coverage, Guaranty Trust Bank (GTB) leads on both ROE and ROA. The ROE differential between GTB and the next bank, Zenith, stood at 560 bps in 2017. Nevertheless, over the past three years, Kenyan banks have dominated on ROE and ROA, with the top three Kenyan banks Equity, KCB and COOP dominating. We attribute the Kenyan bank's lower ROE profile to NIM compression from 2016 as a result of interest rate caps introduced in September 2016.

Figure 6: GTB leads on ROE

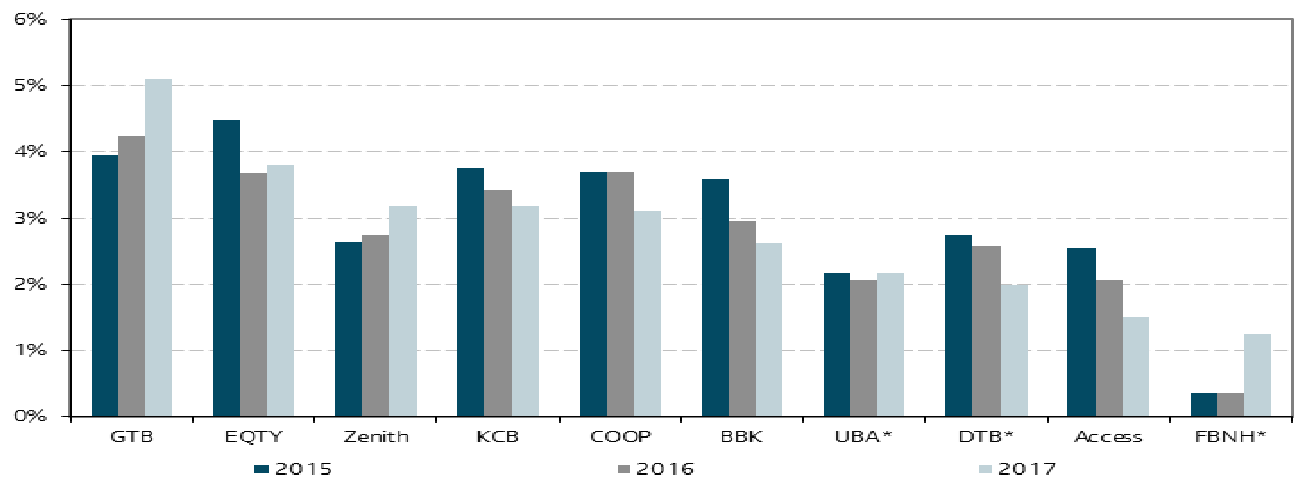


Source: Company financials, SBGS analysis, * 9M 17 figures

Median ROE for our coverage declined by 300 bps to 16% in 2017 from 19% in 2015, driven by a 560 bps decline in the Kenyan banks during the period. We believe that the introduction of interest rate caps in 2016 was partly responsible for the decline in returns. Hence, a revision in the policy expected in the next few months should improve the return profile of Kenyan banks materially.

In our view, GTB's superior ROE is supported by notable balance sheet growth, strong NIMs and efficiencies despite some asset quality concerns.

Figure 7: GTB leads on ROA



Source: Company financials, SBGS analysis,* 9M 17 figures

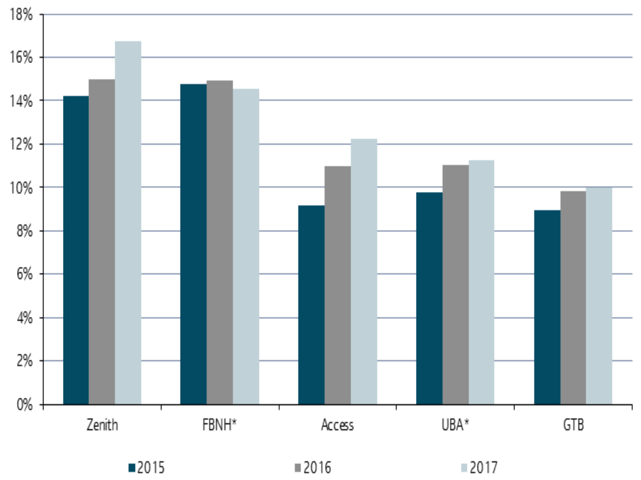
Despite the dominance of Nigerian banks such as GTB and Zenith on our profitability league table, Kenyan banks have held their own even in a rate cap environment by driving NIR and improving cost efficiencies over the past two -years. FBNH and DTB have lagged during the same period underperforming their peers, mainly due to their asset quality challenges.

Both markets are reasonably concentrated

Total assets

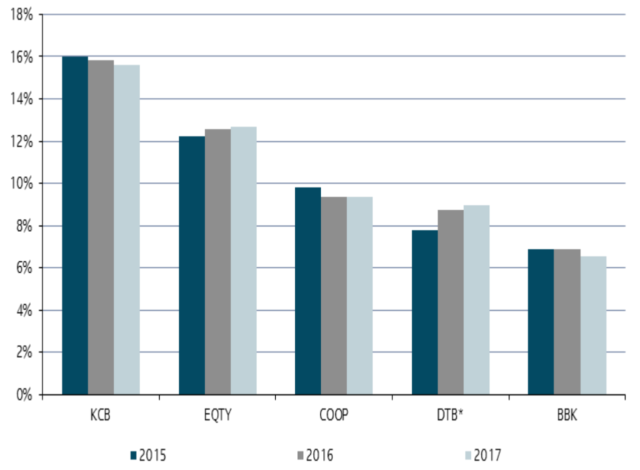
The Kenyan and Nigerian banks are reasonably concentrated with the top five banks in both markets accounting for c.65% and 53% of sector assets respectively. One caveat for our analysis is that we use October 2017 sector total assets figures for Kenyan banks and July 2017 figures for Nigerian banks. The assets of the Kenyan banking sector stood at USD40bn vs. USD101bn for the Nigerian banking sector.

Figure 8: Nigerian banks' market share of assets



Source: Company financials, SBGS analysis,* 9M 17 figures

Figure 9: Kenyan banks' market share of assets



Source: Company financials, SBGS analysis,* 9M 17 figures

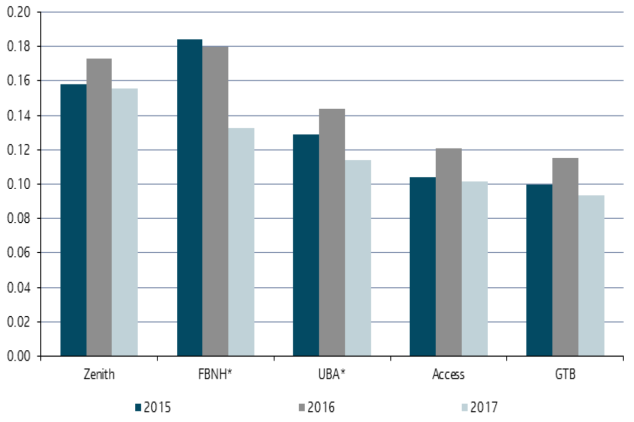
In Nigeria, Zenith Bank dominates with a market share of 17%, while KCB is the dominant bank in Kenya with a market share of 16%. Within the top five, GTB has the lowest market share in Nigeria at 10% while BBK has the lowest in Kenya at 7%.

We note FBNH is the only Nigerian bank to have shed market share over the past three years. While in Kenya, Equity and DTB are the main market share winners over KCB, COOP and Barclays Kenya.

Customer deposits

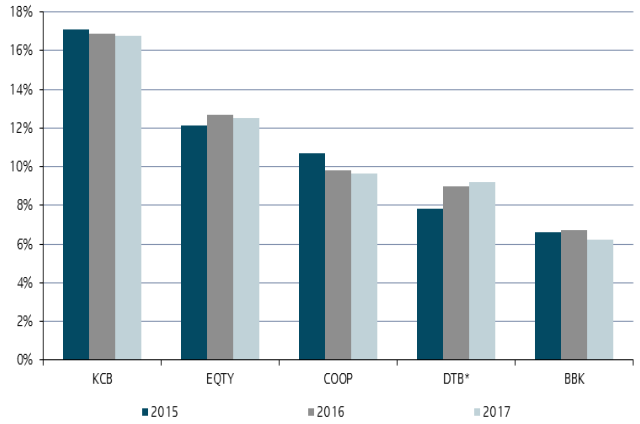
Concentration of deposits is also high at 54% for Kenyan banks but higher with Nigerian banks at 60%. Deposit market share has been declining for the top five banks in Nigeria from 68% in 2015. **We attribute this to increased liquidity tightening in Nigeria, which has resulted in higher competition for deposits in the sector.**

Figure 10: Nigerian banks' market share of customer deposits



Source: Company financials, SBGS analysis,* 9M 17 figures

Figure 11: Kenyan banks' market share of customer deposits



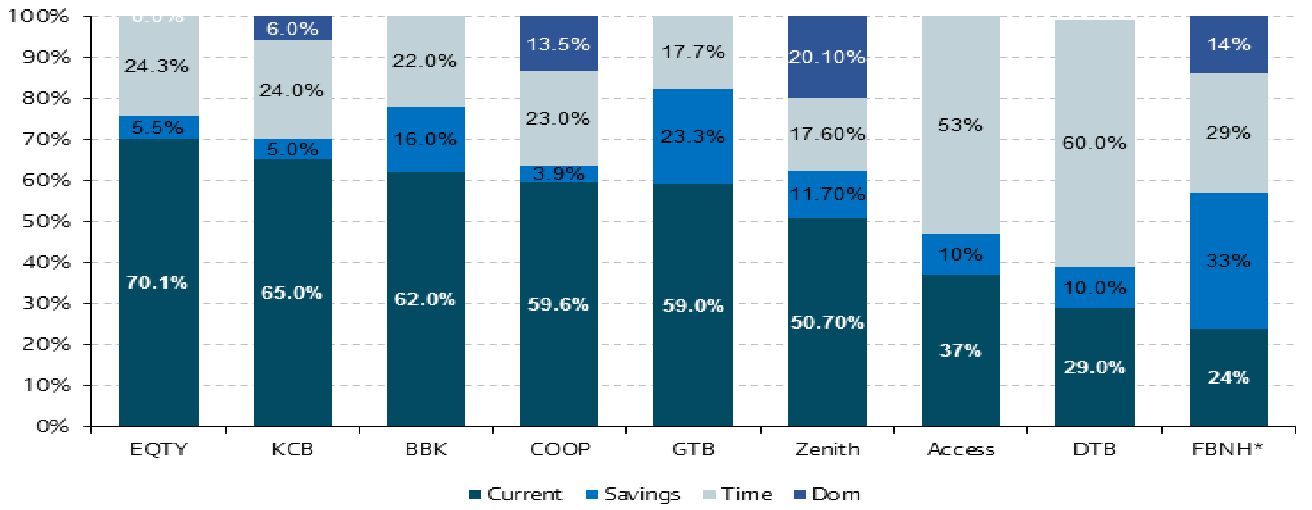
Source: Company financials, SBGS analysis,* 9M 17 figures

In Kenya, market share of deposits for the top five banks has remained reasonably constant, if we include the next five banks we note an increase in market share by c.300 bps. We attribute this deposits movement to 'flight to quality' experienced post the collapse of three banks in the Kenyan market starting in early 2015. We maintain that deposit concentration in a capped rate environment would be negative for system-wide credit growth, as the banks benefiting from increased liquidity would be unlikely to originate loans when yields on treasuries offer better risk-adjusted returns.

Low cost deposits concentration in both markets

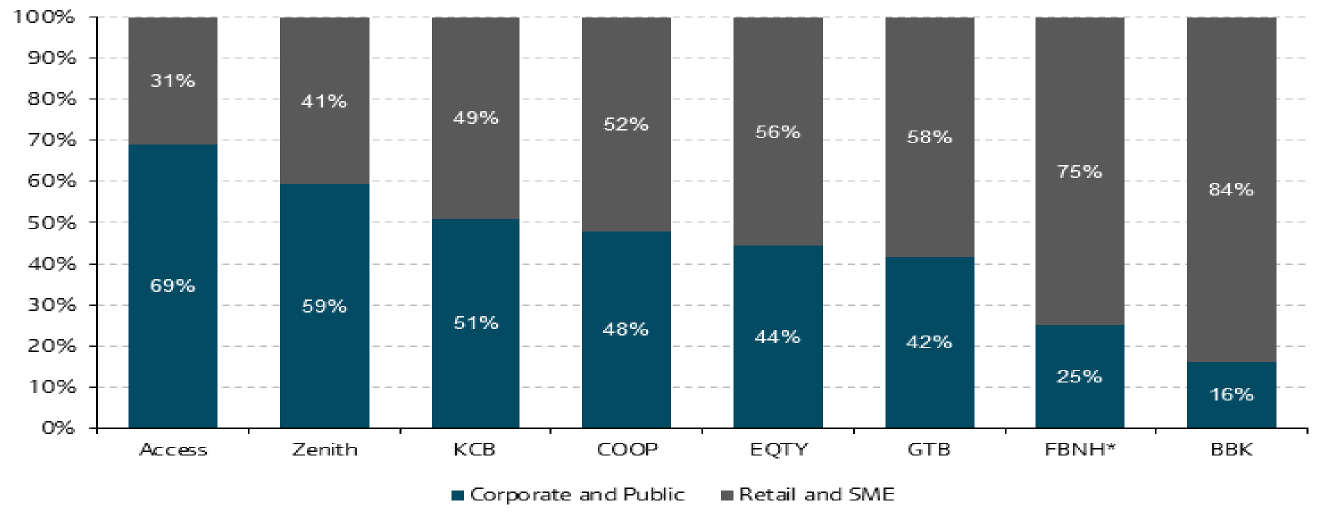
Below we show the deposit mix of the sector by type and by segment. Low-cost current and savings accounts are drivers of deposits for these banks with a higher concentration of retail and SME deposits. Retail and SME customers are less price sensitive hence the higher demand for such deposits. We see this reflected in funding costs.

Figure 12: Deposit split by type



Source: Company financials, SBGS analysis,* 9M 17 figures

Figure 13: Deposit split by segment



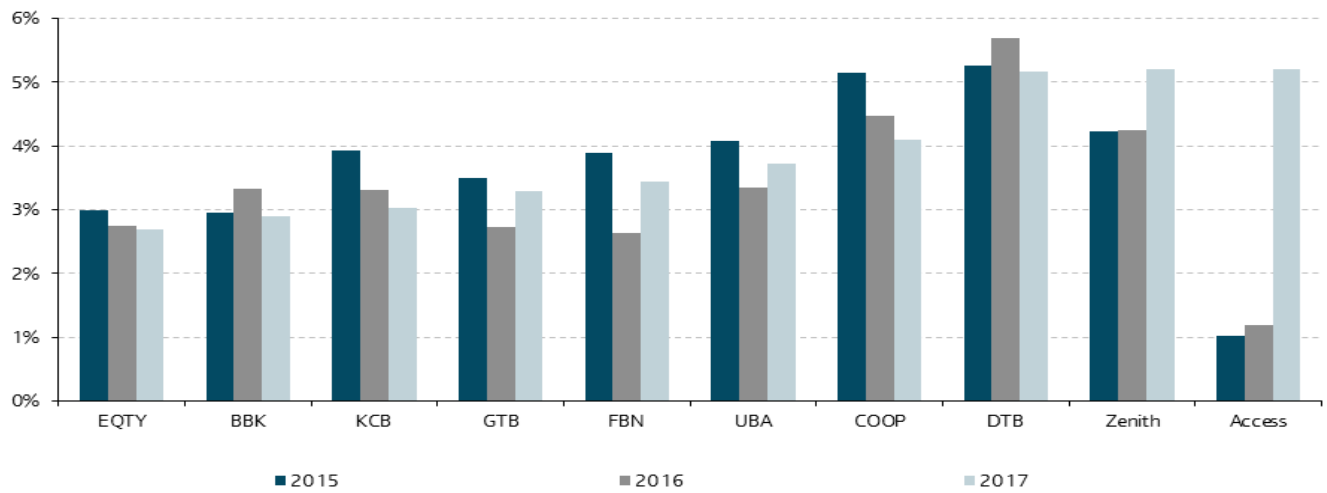
Source: Company financials, SBGS analysis,* 9M 17 figures

Kenyan banks have lower funding costs

The Kenyan banks have the lowest funding costs within our coverage, with Equity Bank leading the pack. Barclays Kenya and KCB also have considerably low funding costs than our overall coverage. In our view, the lower funding costs are as a result of their larger than average retail segment compared to peers.

We suspect that tight liquidity conditions in Nigeria over the past three years have been responsible for the higher cost of funds in Nigeria relative to Kenya. Over the past three years, the Central Bank of Nigeria has tightened liquidity to reduce demand for foreign exchange and curb inflation. Within our Nigerian coverage, GTB's funding costs have been the lowest, while Access and Zenith have struggled to contain funding costs. We expect the trend to change given more stable FX conditions and declining inflation.

Figure 14: Cost of funds

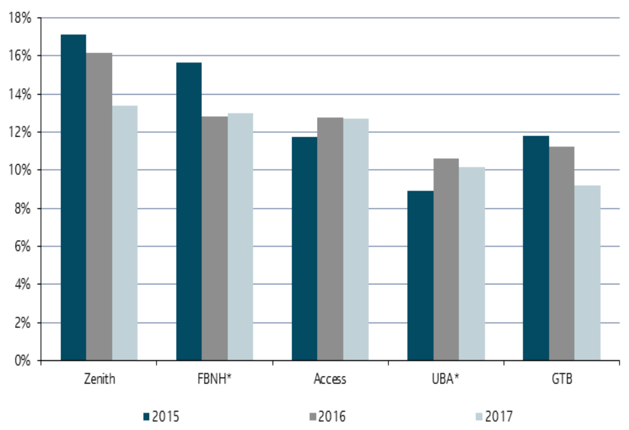


Source: Company financials, SBGS analysis,* 9M 17 figures

Customer loans

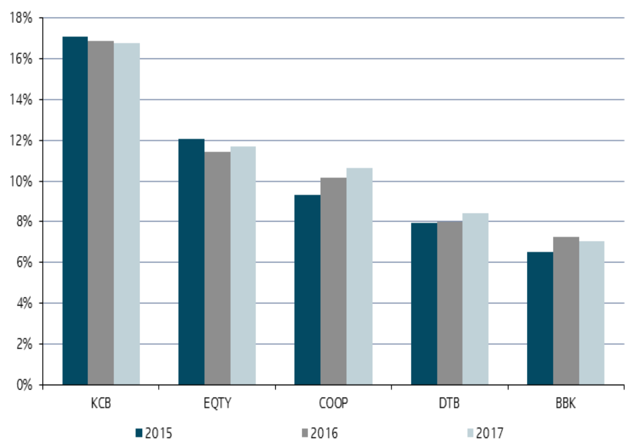
Customer loan market share of the top five Kenyan banks increased slightly to 55% in 2017 from 53% in 2015; however, loan market share of the top five banks in Nigeria declined considerably to 58% in 2017 from 65% in 2015. KCB dominates the Kenyan banks on customer loans at c.17% over the past three years, while Zenith Bank dominates the Nigerian banking sector at 13%.

Figure 15: Nigerian banks' market share of customer loans



Source: Company financials, SBGS analysis,* 9M 17 figures

Figure 16: Kenyan banks' market share of customer loans



Source: Company financials, SBGS analysis

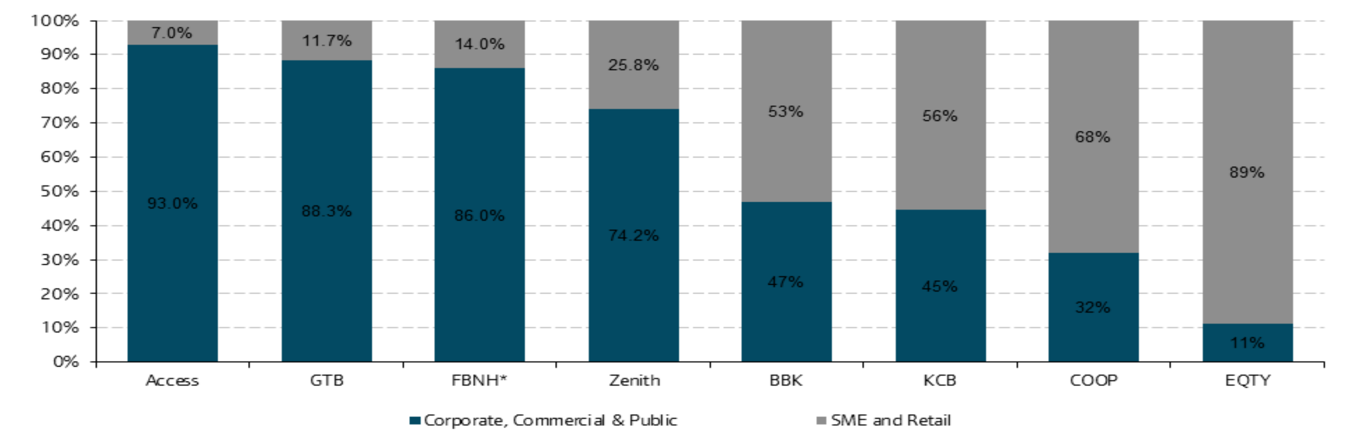
The Nigerian banks have been deleveraging over the past three years, with a focus on reducing foreign currency loans. The tight liquidity environment has also depressed private sector credit for the sector as a whole.

In Kenya, the market share shift in deposits in favour of the larger banks and the interest rate caps have left the smaller banks unable to lend, in our view, due to liquidity constraints and margin compression. However, should interest rate reforms be favourable, we may see the large banks' loan market share reduce.

Loan segments vary across both markets

Corporate, commercial and public sectors dominate loans for the Nigerian banks while there appears to be a higher contribution from the SME and retail segment for Kenyan banks below. One caveat of our analysis is that our Kenyan bank numbers are best estimates based on annual reports where the information was not readily available.

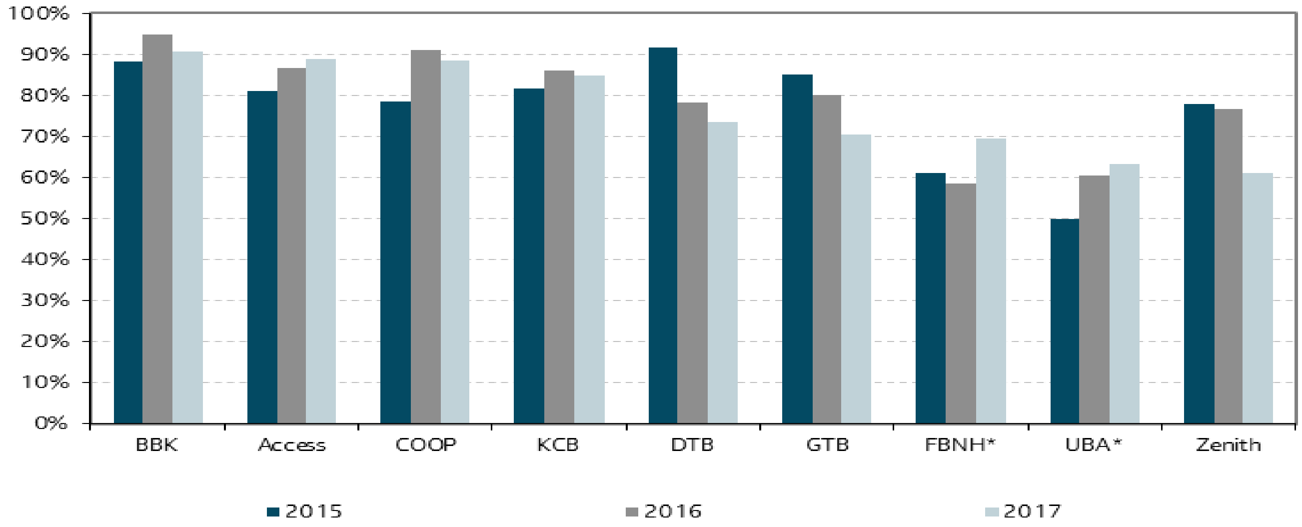
Figure 17: Customer loans by segment



Source: Company financials, SBGS analysis,* 9M 17 figures

Loan-to-deposit ratio appears higher for the Kenyan banks at 84% vs. 71% for Nigerian banks.

Figure 18: Sector loan-to-deposit ratios

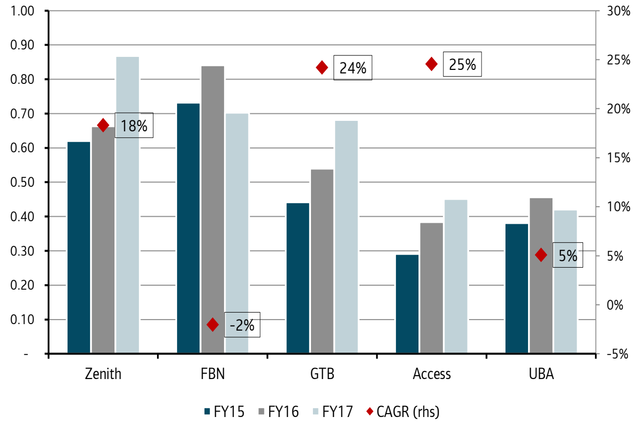


Source: Company financials, SBGS analysis,* 9M 17 figures

Net interest income

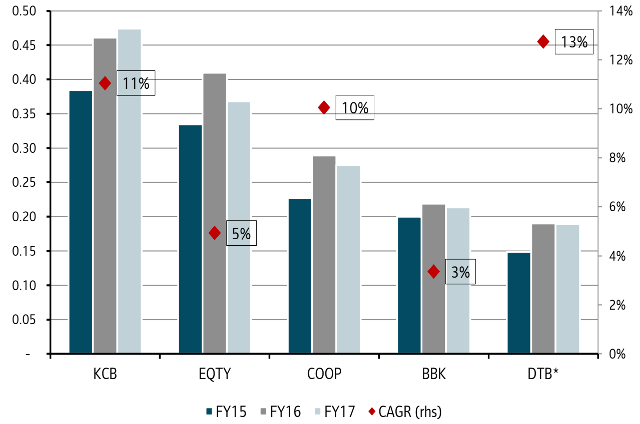
Nigerian banks dominate three-year NII CAGR performance

Figure 19: Nigerian banks' 3-yr NII performance



Source: Company financials, SBGS analysis

Figure 20: Kenyan banks' 3-yr NII performance



Source: Company financials, SBGS analysis. *9M17

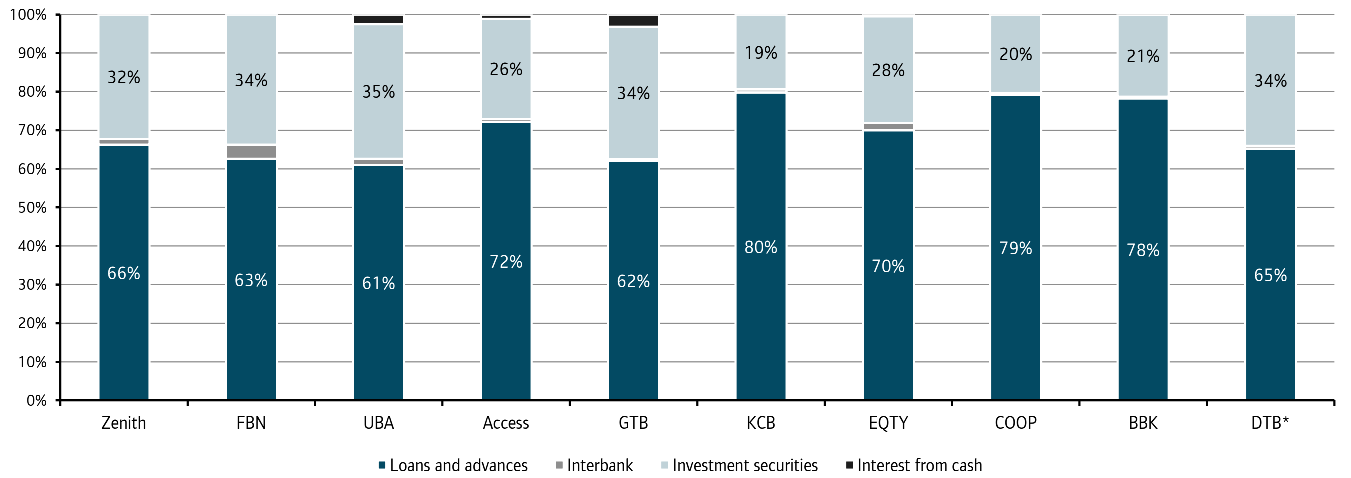
Our analysis highlights that Nigerian banks have outperformed Kenyan banks based on our three-year NII CAGR analysis. Nigerian banks' three-year average CAGR is 14% compared to 8% for the Kenyan banks.

In Nigeria, NIM expansion has been the main driver of strong NII growth in the market with the strongest three-year CAGR from Access Bank.

In Kenya, overall NII performance has been decent supported by government yields as banks opted to hold back loan growth in favour of risk-free assets and lower funding costs with most banks favouring current deposits over term deposits since the imposition of a deposit floor.

NII contribution is comparable across both markets

Figure 21: 2017 interest income contribution highlights fairly similar proportions across the two banking sectors



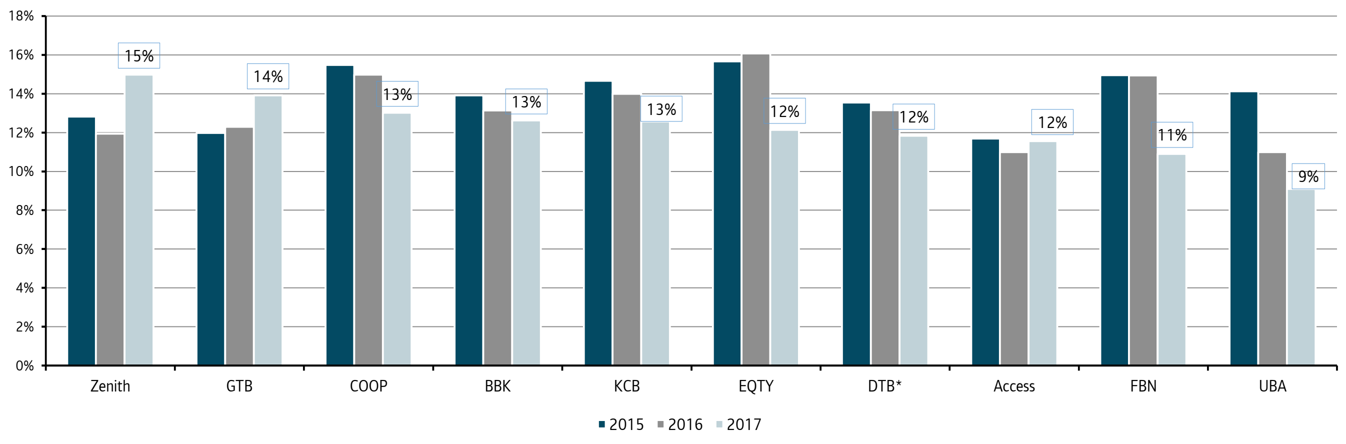
Source: Company financials, SBGS analysis. *9M17

The strong contribution from interest income from loans and advances is not surprising across both markets. It's worth noting that the contribution from investment securities grew in FY17 vs. FY16. In Nigeria, it grew from an average of 25% in FY16a to 30% in FY17 and in Kenya from 25% in FY16a to 27% in FY17a.

The change in contribution in Kenya was as a result of muted loan growth for most of our coverage names despite decent deposits growth during the year. Difficult economic conditions in Nigeria resulted in loan book contraction in real term as banks reduced their risk appetite, deploying funds to T-bills. Yields on T-bills was high over the period.

Loan yields lower across both markets

Figure 22: Declining loan yields evident for Kenyan banks



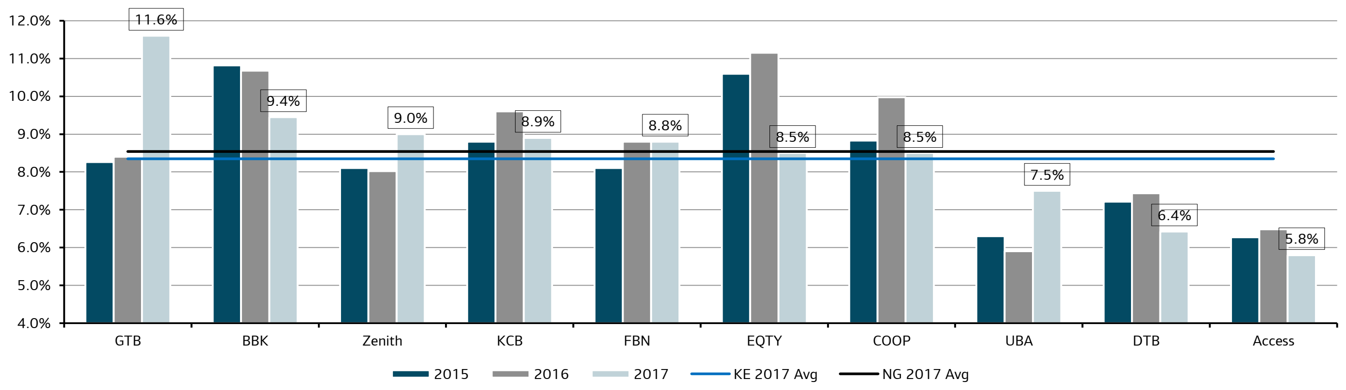
Source: Company financials, SBGS analysis

Nigerian bank loan yields declined from an average of 13.1% in 2015 to 12.1% in 2017. Zenith and GTB bucked the trend with loan yields increasing in FY17 by 300 bps and 160 bps respectively.

Kenyan bank loan yields declined from an average of 14.7% in 2015 to 12.4% in 2017. The three local banks EB, COOP and KCB were the worst hit with loan yields declining by 350, 247 and 210 bps respectively. Post interest rate caps, lending yields are less divergent across the large retail banks ranging between 12.5% and13.0%. Should interest rate cap reforms be favourable to SME market lending, we expect these three banks to be the main beneficiaries.

Nigerian banks dominate NIMs

Figure 23: Rising NIMs for the Nigerian market compared to declining yields in the Kenyan market



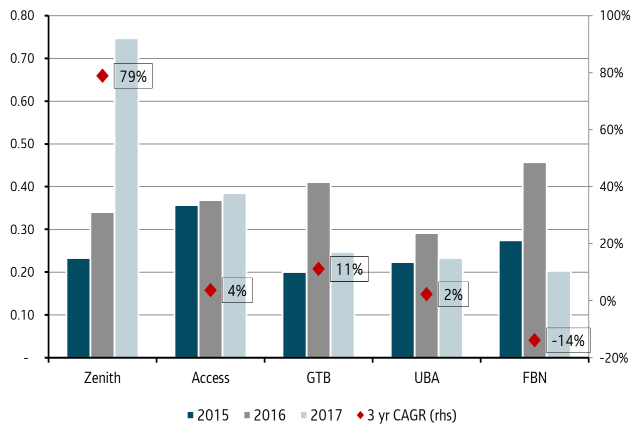
Source: Company financials, SBGS analysis

Nigeria's GTB's NIMs rank top in our coverage at 11.6%. BBK comes second at 215 bps below GTB at 9.4%. However, we note that pre-rate caps, Kenyan banks' NIMs were on average higher than those of Nigerian banks.

Non-interest income

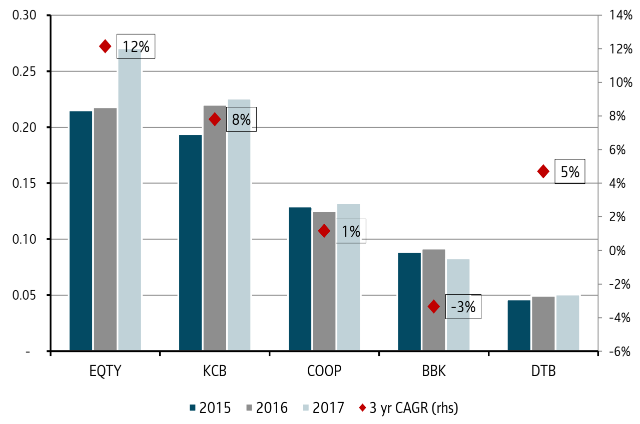
CAGR, Zenith leads

Figure 24: Nigerian banks' NIR performance



Source: Company financials, SBGS analysis

Figure 25: Kenyan banks' NIR performance



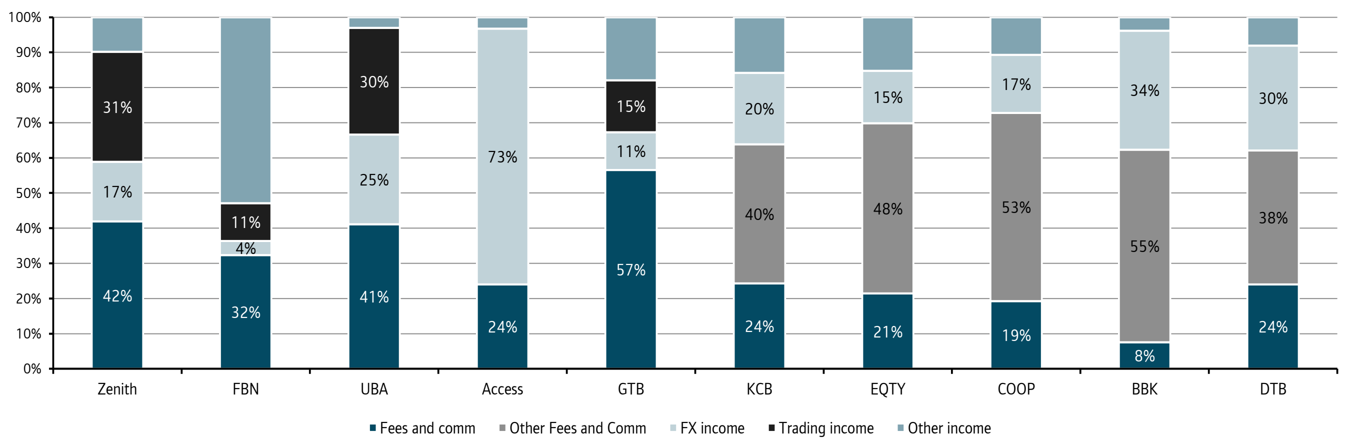
Source: Company financials, SBGS analysis

Zenith's NIR has outperformed the past three years with a CAGR of 79% driven by a combination of foreign currency revaluation gains and derivative income, which we can argue are poor quality as they are unsustainable.

Equity Bank comes in a distant second with an NIR CAGR of 12% as its investment in alternative channels has improved its non-loan related fee income through increased transactions.

Line item contribution of NIR

Figure 26: 2017 percentage contribution of non-interest income drivers



Source: Company financials, SBGS analysis

Please note we have matched the individual line items as best we can based on our analysis of the underlying revenues. We highlight the following differences:

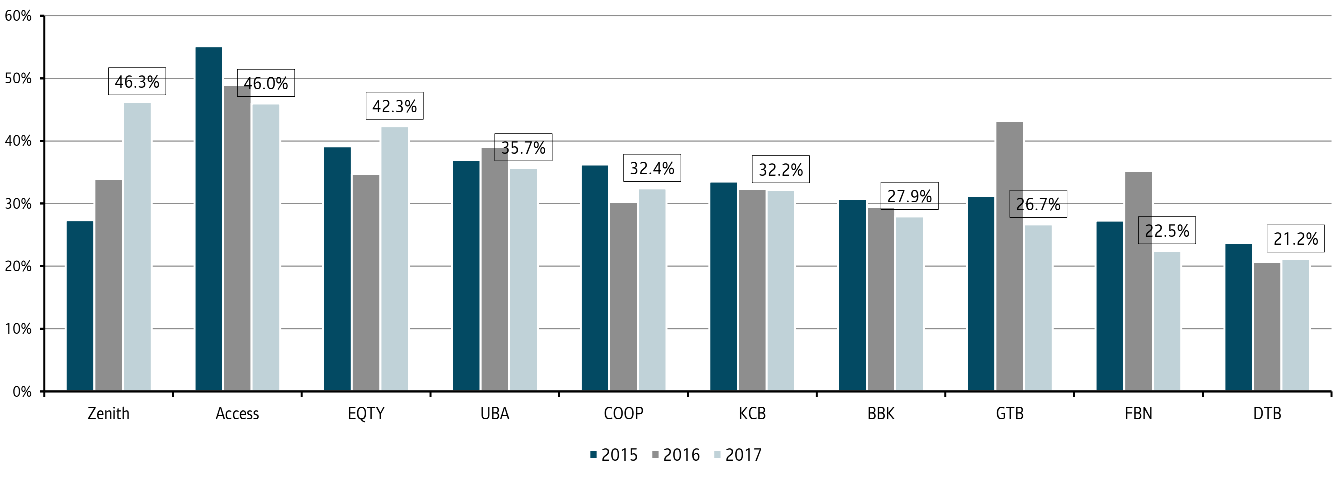
- Fees and commission income in Nigeria includes other fees and commission that are related to loan fees, current account maintenance income, foreign exchange commission, card-related fees and e-business income.
- Nigerian banks' trading income relates to income from T-bills and bond trading.
- Other fees and commission in Kenya relates to all non-loan fees and commission. This is mainly transactional revenues across the various bank channels.

Access Bank clearly dominated FX revenues (73% contribution to NIR) across our coverage while GTB leads on fees and commission income (57% contribution to NIR).

Kenyan banks' investment in alternative channels has helped them to increase other fees and commission despite weakness in loan fee and commission income from lower loan growth. With most transactions going through alternative channels for most of the banks, it's understandable that other fees are a dominant contributor of NIR in the absence of loan growth.

NIR-to-total income growth over three years

Figure 27: NIR to total income

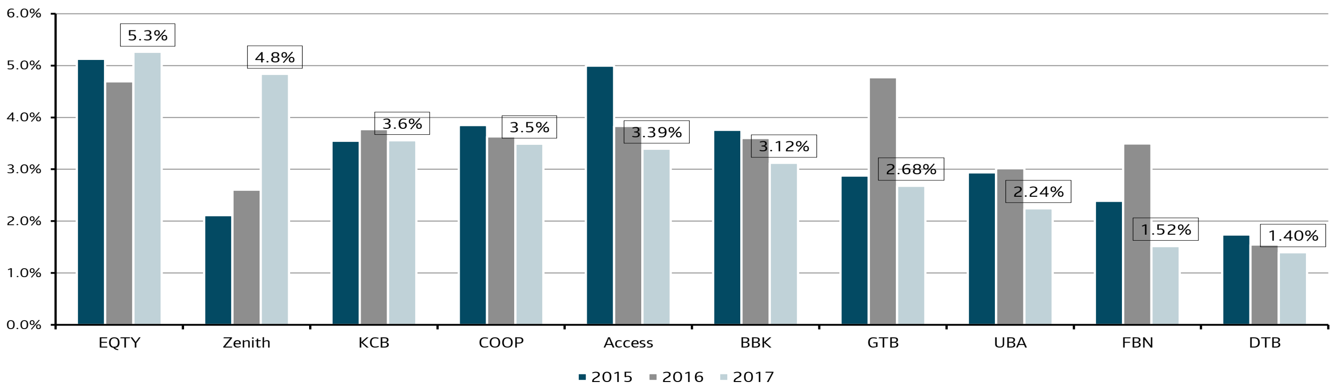


Source: Company financials, SBGS analysis

Zenith tops the ranking for FY17 NIR contribution to total income, followed closely by Access Bank. With Equity coming in third, we note NIR contribution is above 40% compared to an average of 28% for the other banks.

NIR yields

Figure 28: NIR to total assets



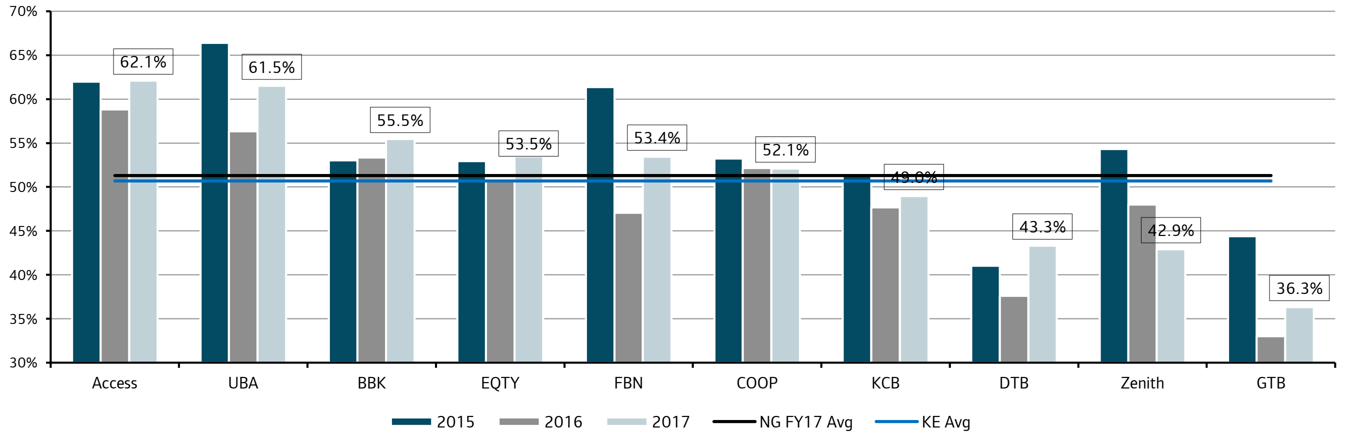
Source: Company financials, SBGS analysis

When we rank NIR yields, Equity takes first position placing Zenith in second position. KCB and COOP follow in third and fourth displacing Access Bank. We believe what distinguishes the banks with higher NIR yields is a large retail/customer base that translates into higher volumes of transactions than the majority of their peers. As such, NIR yields will tend to favour larger retail banks. We see a downside to Access' NIR as FX derivative income outlook is declining given increased FX stability. We expect demand for and pricing of FX swaps to the Nigerian sovereign to contract.

Operating costs

Cost-to-income ratios

Figure 29: Cost-to-income ratios



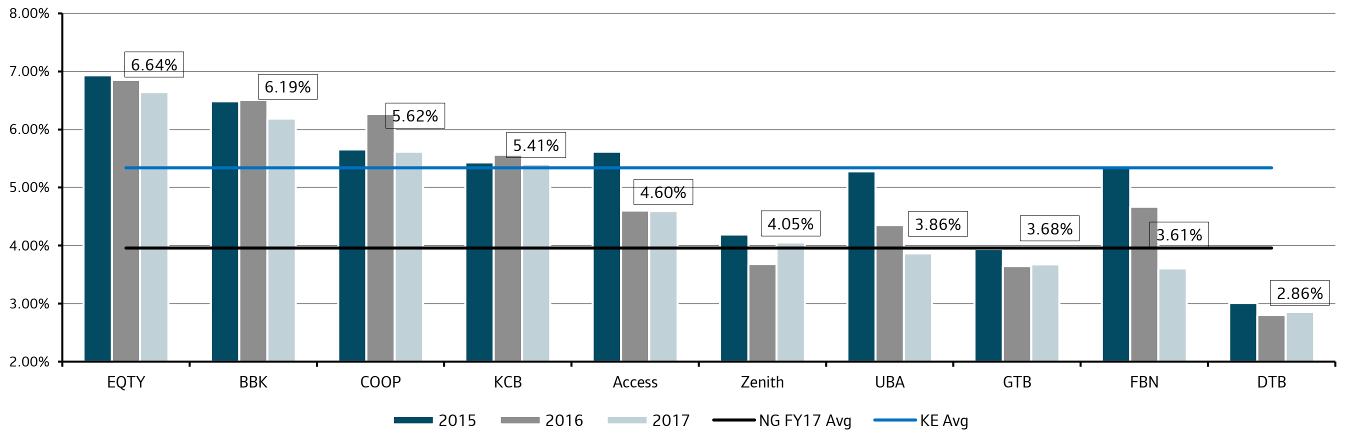
Source: Company financials, SBGS analysis

On average, both markets have similar cost-to-income ratios; 51.3% average for the Nigerian banks and 50.7% for the Kenyan banks.

On a company level, however, the differences are quite notable. GTB is the most efficient bank in our coverage with an average (FY15 - FY17) cost-to-income ratio of 38% followed by DTB with an average of 41%. We note that for both banks staff costs contributed less than 40% of total costs in FY17.

Operating costs to assets

Figure 30 : Operating expenses to assets



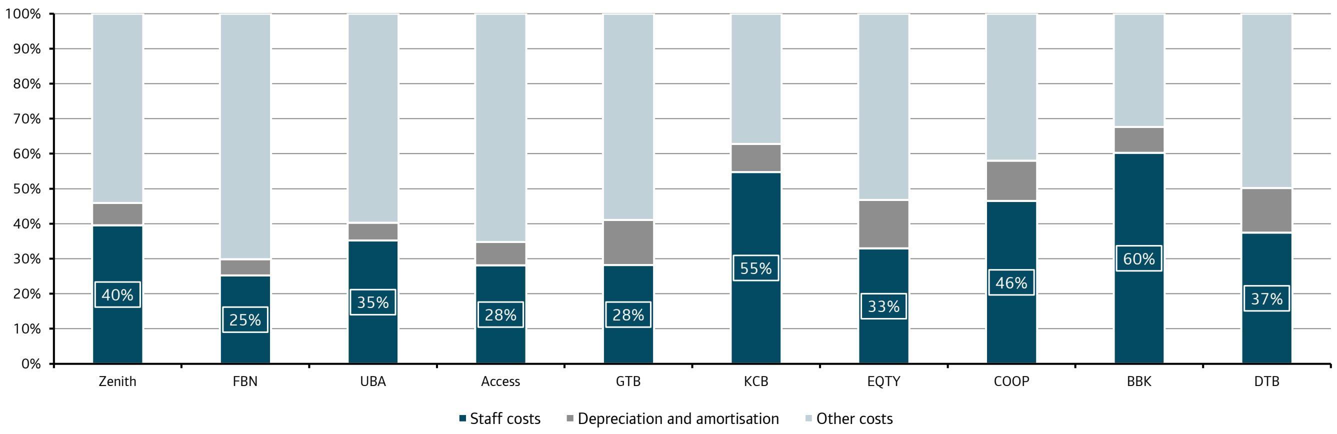
Source: Company financials, SBGS analysis

Based on average opex to assets for the two markets, it is clear that the Nigerian market is more efficient with only 4.0% operating costs to assets compared to 5.3% for the Kenyan market.

Kenyan banks both best and worst positioned. DTB stands out on this metric with the lowest operating costs to assets over the past three years. Equity Bank, on the other hand, is the least preferred on this metric with the highest level of 6.6% in FY17.

Operating costs split

Figure 31: Operating costs contribution



Source: Company financials, SBGS analysis

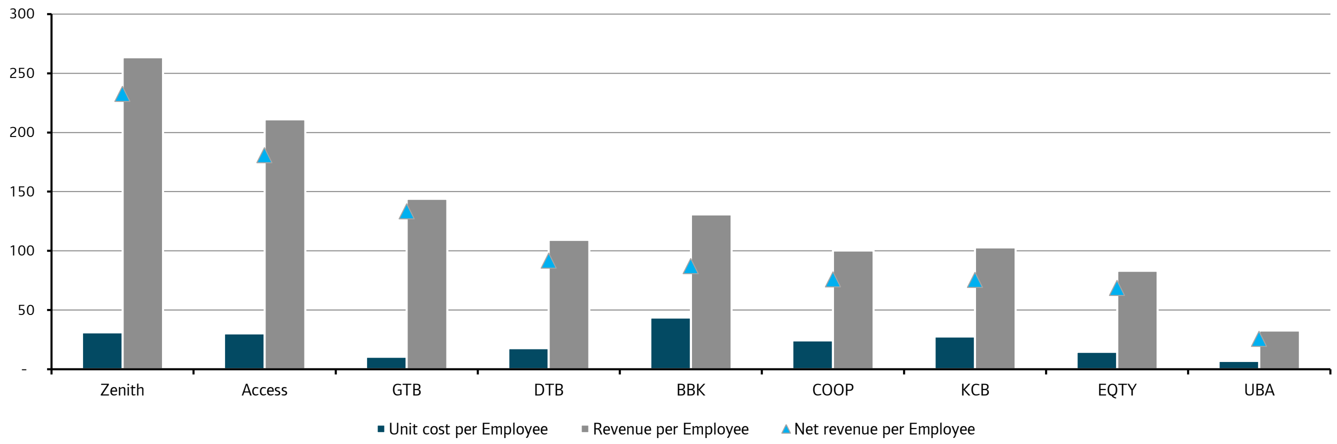
It is interesting to note that staff costs in Nigeria are only on average 31% of total operating costs, whereas in Kenya it is much higher at 46% of total costs.

Nigerian banks: A number of banks have contract staff to handle functions such as customer service and some levels of branch operation, which typically costs less than full-time staff.

Kenyan banks: The Kenyan banking sector for the most part still runs a branch-heavy distribution model and only recently have we seen investments in alternative banking channels, including agents, online and mobile platforms.

Net revenue per employee

Figure 32: Net revenue per staff employee in USD (000)



Source: Company financials, SBGS analysis

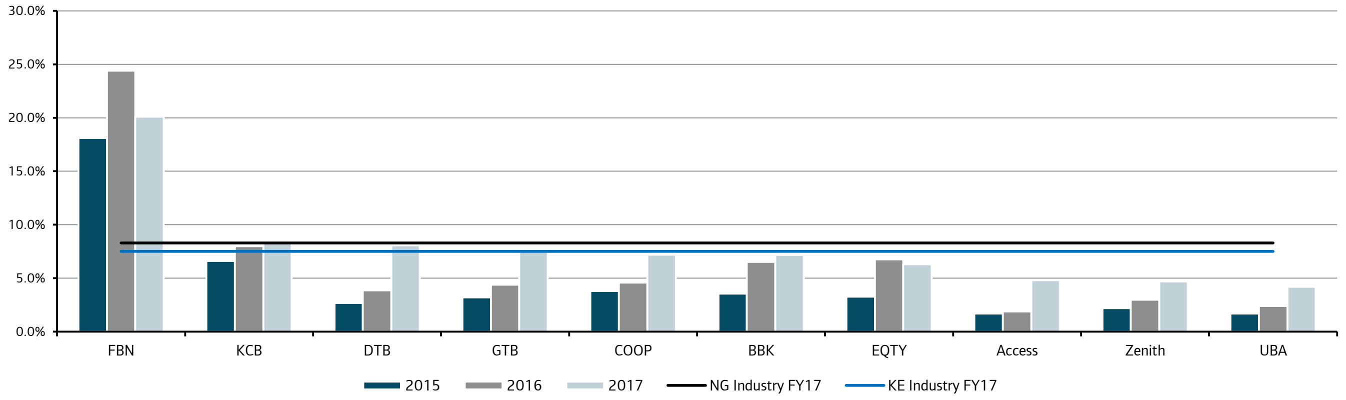
Our analysis above shows the unit cost per employee (operating costs/number of employees), revenue per employee (total revenue/number of employees) and net revenue per employee (revenue less costs per employee).

We note that while Zenith's unit cost per employee is the highest in the Nigerian market, it also has the highest revenue per employee and net revenue per employee in our coverage. UBA and Equity trail their peers on this measure with the lowest net revenue per employee.

Asset quality

NPL ratios, we note asset quality deterioration across both markets

Figure 33: NPL ratios



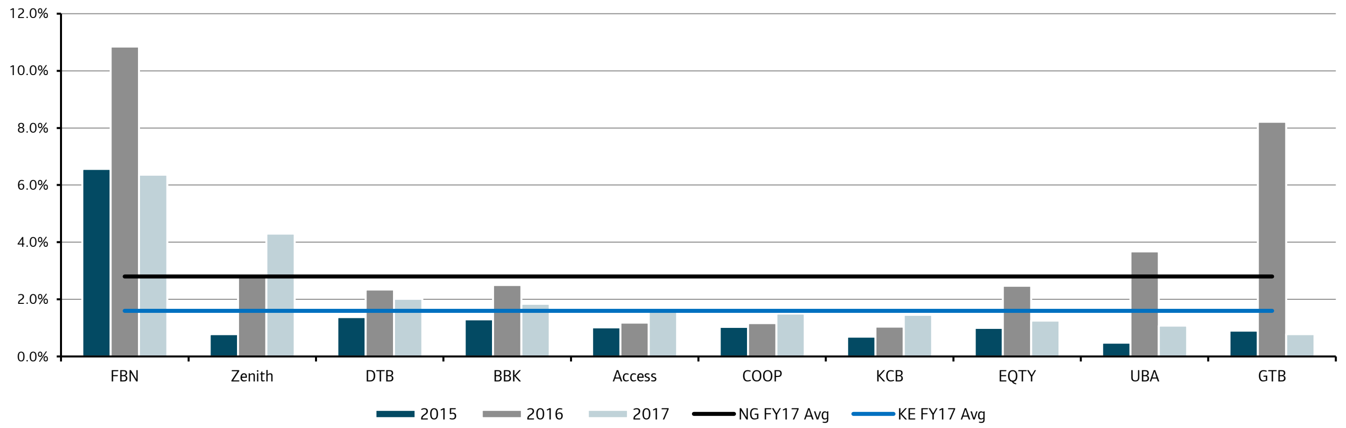
Source: Company financials, SBGS analysis

We note asset quality deterioration in both markets. In Nigeria, NPL ratios moved from an average of 5.4% in 2015 to 8.3% in 2017. In Kenya, NPL ratios moved from 4.0% to 7.5% in 2017.

While FBN has had the most notable asset quality issues over the past three years, we note the improvement in NPL ratio in FY17 compared to FY16.

Cost of risk

Figure 34: Cost of risk for the past 3-years



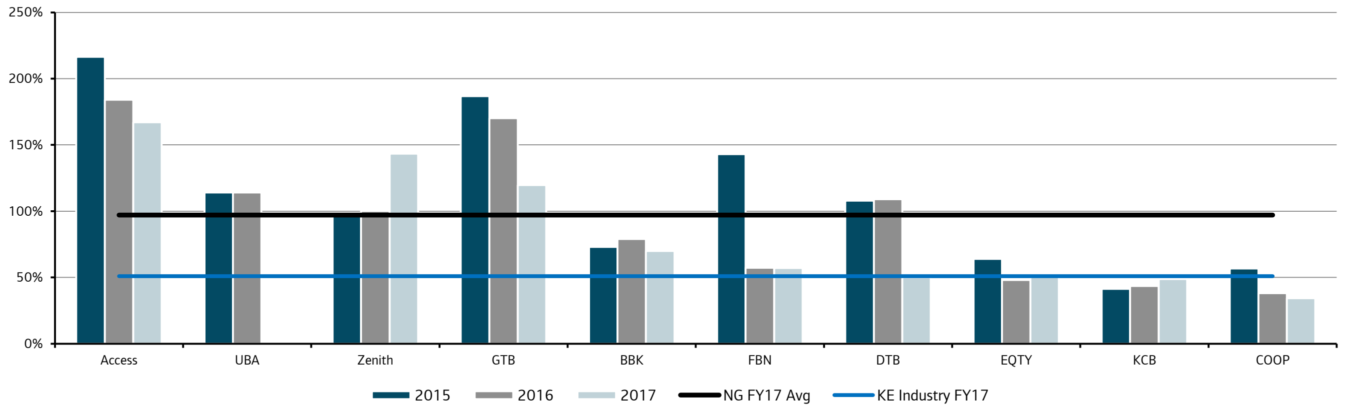
Source: Company financials, SBGS analysis

For Nigeria, the weak macro has been a key driver of recent asset quality deterioration with sectors such as power, general commerce, oil and gas and telecoms driving impairments.

Kenyan banks' elevated 2017 cost of risk is due to sector asset quality issues in 2017 as a result of a muted business environment in an election year.

Coverage levels much higher in Nigeria than Kenya

Figure 35: Coverage levels across Nigeria and Kenya



Source: Company financials, SBGS analysis

Nigerian banks include regulatory reserves in the NPL coverage figure, if we back that out coverage for most banks is lower than 100%.

Companies Mentioned (Price as of 2018/03/22)
Access Bank Plc (ACCESS.LG, N11.10, BUY, TP N13.71)
Barclays Bank of Kenya Ltd (BBK.NR, KSh12.65, HOLD, TP KSh11.60)
Co-operative Bank of Kenya (COOP.NR, KSh19.45, HOLD, TP KSh18.60)
Diamond Trust Bank Kenya Ltd (DTK.NR, KSh216.00, SELL, TP KSh163.00)
Equity Group Holdings Ltd (EQTY.NR, KSh52.50, BUY, TP KSh54.00)
FBN Holdings Plc (FBNH.LG, N12.05, HOLD, TP N10.10)
Guaranty Trust Bank Plc (GUARANT.LG, N44.95, BUY, TP N57.00)
Kenya Commercial Bank Ltd (KCB.NR, KSh51.50, BUY, TP KSh55.00)
United Bank for Africa Plc (UBA) (UBA.LG, N11.75, HOLD, TP N11.36)
Zenith Bank Plc (ZENITHB.LG, N28.80, BUY, TP N35.00)

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Diamond Trust Bank Kenya Ltd	D
Equity Group Holdings Ltd	D
FBN Holdings Plc	D
Guaranty Trust Bank Plc	D
Kenya Commercial Bank Ltd	D
United Bank for Africa Plc (UBA)	D
Zenith Bank Plc	D

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