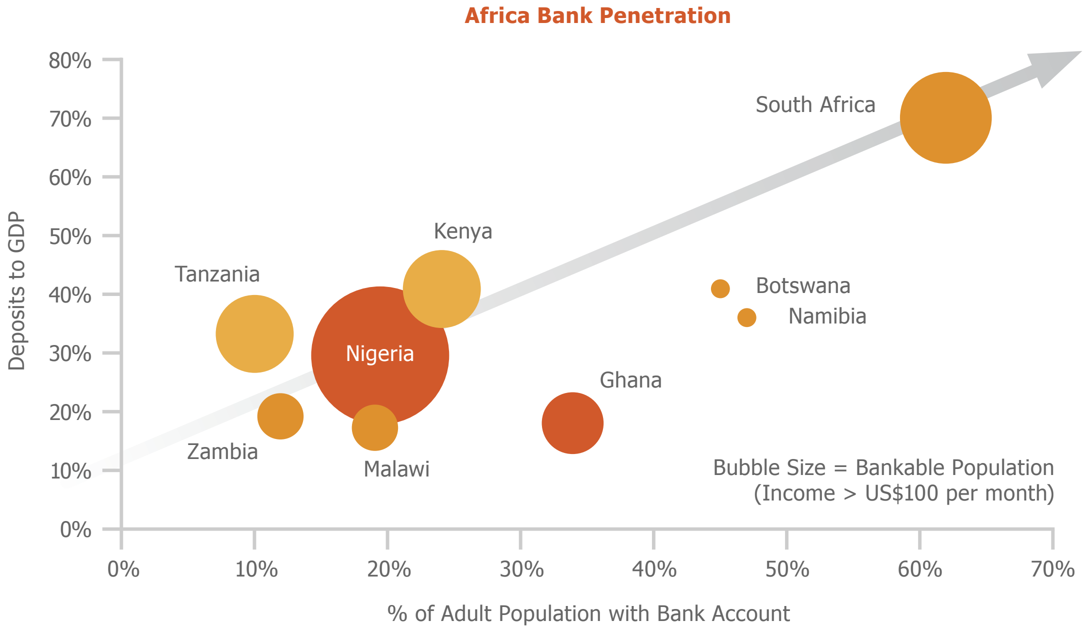
Banking on Africa

A closer look at Sub-Saharan banking

FMG Africa Report | 2014

GROWTH AND OPPORTUNITIES IN AFRICA



Source: Altree Capital, BankScope, IMF

Sub-Saharan Africa (SSA) is home to almost 1 bn people living south of the Sahara and north of the Limpopo River which marks the border with South Africa. Most banks in SSA are small in absolute and relative size. They are characterized by low loan-to-deposit ratios and large shares of assets held in the form of government bonds and liquid assets. Bank lending is mainly short-term in nature, with a majority of loans having a maturity of less than one year. The banking industry is characterized by modest reach in terms of providing financial services to the population. A substantial part of the population is unbanked, small and medium enterprises (SMEs) are mostly constrained in their access to any form of credit. However, SSA's banking industry is poised to enjoy a surge in growth during this decade. Three of the main drivers of this development are:

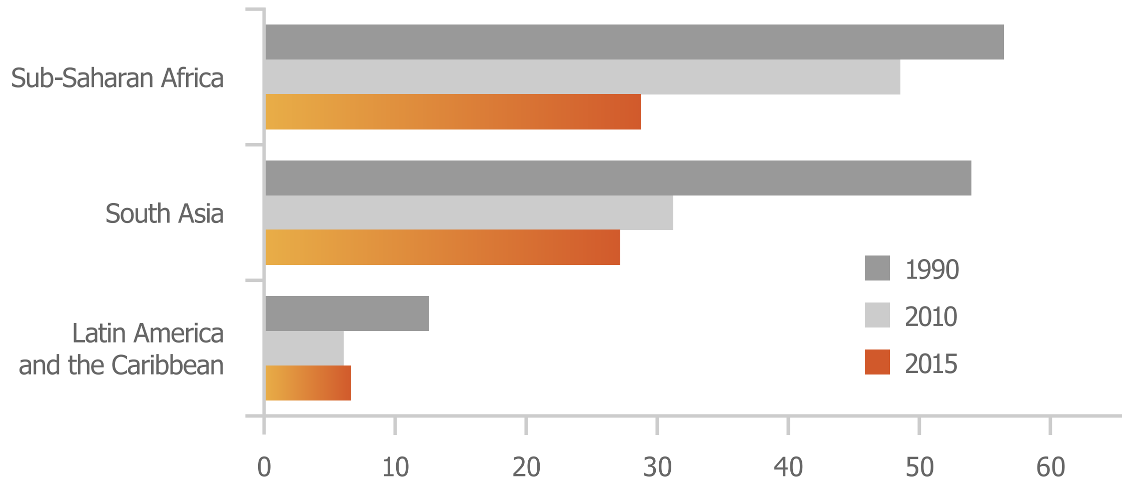
1) High rates of economic growth
2) Growth in basic financial services
3) New technologies

HIGH RATES OF ECONOMIC GROWTH

Many countries in SSA have seen accelerated growth for an extended period since the mid-1990s. Their GDP has averaged 4.5% between 2000 and 2009, and 7 of the 10 fastest growing economies globally in the next 5 years are projected to be African. Poverty rates in SSA are projected to decline at the fastest pace globally.

SSA continues to show huge economic potential with vast natural resources and favorable demographics. However, the regions downside risk includes weakening socio-economic and political conditions.

Headcount Poverty Index Using US$ 1.25/day Poverty Line



Source: World Bank, World Development Indicators

GROWTH IN BASIC FINANCIAL SERVICES

The banking industry in most of SSA remains underdeveloped as compared to other developing region's. The continent has roughly 70-80% of its population which is unbanked – thus tremendous growth potential.

Banks hold the majority of financial sector assets and activities in SSA. Helped by reform the depth and coverage of the financial system – as measured by the ratios of broad money (M2) and private sector credit to GDP – have been gradually increasing over the past decade, albeit from a low base. The scope for further financial industry growth is significant which is why we have seen a fresh wave of investments coming from foreign banking institutions.

NEW TECHNOLOGIES

In many regards SSA is trailing the rest of the world in developing its banking sector. However, in some key aspects it is already leading in ways that will allow it to rapidly catch up.

Retail banking in Africa is structured quite differently to traditional developed market banks. This is primarily due to the vast size of the continent, which poses a real challenge to traditional distribution models based on branch networks.

In Africa mobile phone penetration has exploded during the last ten years. Between 1998 and 2009, Africa witnessed an increase from 0.5 mobile phones per 100 people to 43. The rapid distribution of mobile phone technology has produced "real-time" connectivity between cities and previously remote rural areas and provided the infrastructure for new payment systems and basic banking services.

The most successful expansion of mobile phone-based banking has been in Kenya where the total number of mobile cash transfers last year amounted to 36% of GDP. Many other African countries are following suit with telecom operator Zain Sudan just recently launching a mobile banking service in cooperation with Bank of Khartoum. At half the size of India, it would be impossible to penetrate the Sudanese financial market effectively through traditional retail banking with bank branches.

> **"The growth of cell phone-based banking provides opportunities for banks to expand their operational reach"**
>
> **– IMF**

FOREIGN INVESTMENTS IN AFRICA

Foreign investors hungry for growth opportunities are increasingly investing in Africa. Standard Chartered Bank opened 35 branches across Africa last year and aims to open another 13 branches this year in Nigeria, Ghana, Kenya and Zambia.

Citigroup operates in over 40 countries in Africa. The company has pledged to source US$ 2.5 bn in incremental capital to improve access to electricity for millions of people across Africa as part of the "Power Africa" initiative. The initiative aims to accelerate investments in Africa's power sector over the next several years with financial assistance coming from the US and governments of several African countries. Citigroup will also leverage its financing expertise in renewable energy to encourage the adoption and implementation of the appropriate technologies for specific markets. The bank will work with key stakeholders in local capital markets to introduce innovative debt securities and to enhance financial infrastructure.

"Retail banking in Sub-Saharan Africa is projected to grow by 15% per annum by 2020"

– African Development Bank

BANKING IN KENYA

Making payments over mobile phones has become big business in Kenya with incumbent mobile phone provider Safaricom facilitating nearly US$ 15 bn of transfers in 2013 through its M-PESA* system. More than 80% of adult Kenyans have made use of mobile money services. The rapid expansion of M-PESA is often cited as an illustration of how new technologies can produce outstanding financial innovations.

M-PESA was launched in 2007 for Safaricom and Vodacom, the largest mobile network operators in East Africa. The service enables customers to transfer money quickly and cheaply without needing to have to set up a costly bank account.

Two of Kenya's largest banks, Equity Bank and Kenya Commercial Bank are rolling out mobile telephony offerings. Ultimately, this will drive significant earnings growth over the medium to long term and pave the way for similar developments in other SSA countries where the mobile banking industry is still in its infancy.

"Voice-call traffic is to double and mobile internet usage is expected to increase 20 times between 2013 and 2019 in SSA - twice the anticipated global expansion"

– Ericsson

*M-PESA – M for mobile, PESA is Swahili for money

BANING IN KENYA – EQUITY BANK

Equity Bank is the largest bank in Kenya with approximately US$ 3.5 bn in assets and 9 mn customers. Despite having a large customer base, the company still sees significant growth potential going forward, with 90% of new customers having bank accounts for the first time. In 2014 the company is targeting 20-30% loan growth, and an ROE of 25%. In April this year, Equity Bank won a mobile virtual network operator license and is preparing to take on M-PESA by launching its paper-thin SIM cards that can be attached to existing SIM cards in mobile phones.

The mobile banking service runs on technology which will enable customers to pay for goods and services by simply tapping their handsets at Point of Sales (POS) terminals. The service includes transfers of money and customers are expected to pay a maximum charge of 25 Kenyan Shillings (KES)* to send any amount of money within the network, compared to the KES 110 fee the telecom operators charge users to transfer the maximum KES 70,000 (US$ 800) within their network. Equity Bank also plans to offer short-term loans to its customers. There is an opportunity for the bank to grow in sizeable markets like neighbouring Tanzania and Ethiopia given the bank's strong reputation in the region.

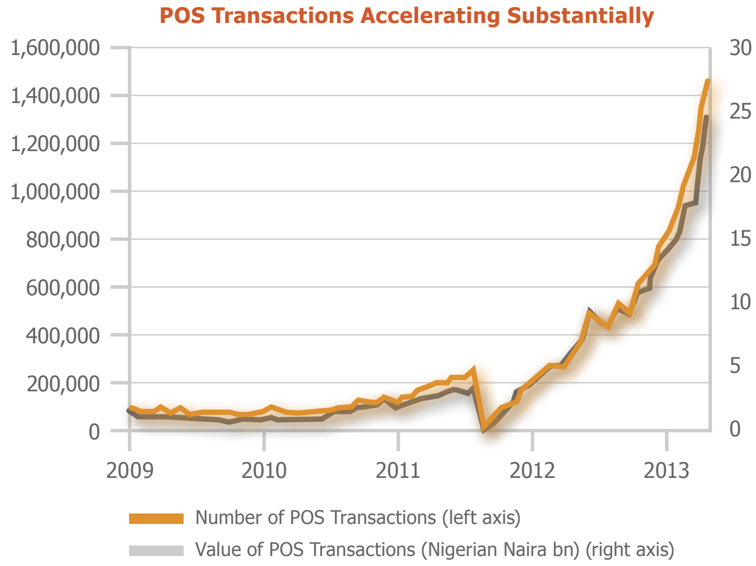
EQUITY Bank The Listening, Caring Financial Partner

*KES 100 = US$ 1.1

BANKING IN NIGERIA

In Nigeria it is common for people to hold on to large sums of cash. However, Point of Sales (POS) terminals have become more dependable and there is an increasing acceptance in usage. Today there are over 15,000 POS terminals throughout the country and growing. Coming off a low base, the number of transactions in 2013 was 163% higher than a year earlier. According to the Central Bank of Nigeria transactions via POS terminals rose to from US$ 10 mn in January 2012, when the service was introduced, to US$ 148 mn in 2014.

At only 1.6 mn transactions a month for a population of around 170 mn people, there is still significant growth potential ahead. An increased use of card transactions will also mean an increased low cost deposit base as more retail money is kept in the banking system as opposed to private safes. In the medium-term the banks' costs to income ratios should be lowered due to the reduced cost of handling cash. This growth in low cost funding will be a key driver for the banks´ earnings growth which is estimated at 15% over the coming decade.



BANKING IN NIGERIA – ZENITH BANK

Zenith Bank is the second largest bank in Nigeria by market capitalization. The customer base is largely corporate with a primary focus on lending to the upstream oil and gas sector. For 2014 the bank is targeting 15-20% loan growth and a 20% ROE. Regulation remains the key issue currently for the banking sector but these issues will abate. Zenith is a high quality bank particularly when comparing financial ratios vs. peer developing banks. It has a high return on equity and good margins while its valuations metrics are attractive both on an absolute and relative basis.

At the same time it has a lot of room to grow its loan book and the prospect to tap into a huge, largely unbanked population. In 2075 Nigeria is estimated to have a population larger than Europe. The best run Nigerian bank today has a US$ 5 bn market cap while the larger European banks have a market cap 10 times bigger. Zenith is growing at a 15% annual rate while European banks have seen sluggish to negative growth.

Zenith Bank vs. its Peers in Developing Markets

	Estimate P/E	Indicated Yield	P/B	NIM	Pretax Margin	ROE	Loan/Deposits
Zenith Bank (Nigeria)	7.7	7%	1.4	8%	40%	20%	56%
ICICI (India)	16.1	2%	2.3	3%	33%	15%	113%
Itau Unibanco (Brazil)	11.0	1%	2.4	5%	27%	22%	150%
Bank Rakyat (Indonesia)	11.7	2%	3.3	9%	53%	29%	88%
Grupo Financiero (Mexico)	16.0	1%	2.2	6%	17%	15%	107%
Turkiye Garanti (Turkey)	10.0	1%	1.4	4%	38%	13%	117%
Standard Bank (South Africa)	12.0	4%	1.7	N.A.	29%	13%	90%

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