Remember the Parable of the Talents? *The parable goes something like this: A man decided to go on a long trip, so he called his servants and asked them to take care of his money. The man decided to give one servant five talents (let's say that it's about $5mn), to another he gave two talents ($2mn) and to the last servant he gave one talent ($1mn). The man left on his trip and the servants each did something with the money that they received. After a nice long trip the master came back and wanted to know what his servants did with his money. The first man with the five talents said, "You trusted me with five talents ($5mn) and I made five more." He gave him $10mn! Then the man with the two talents came and said, "You trusted me with two talents and I made two more!" Then the man who received the one talent told his master, "I know you work hard for your money, so I was afraid to lose any of it. I decided to bury it and keep it safe. Here is your one talent back." The master was not impressed and said, "You lazy servant!"*

The Master in this parable is analogous to the discerning shareholders looking for return on their investments in Markets, whereas the servants in this parable are the Management team of the various companies that portfolio managers decide to invest in, in their hunt for **Alpha**. The earnings season has come and gone and you are left wondering what companies really outdid themselves, what companies did okay in this tough macro environment and what companies did not come to the party at all.

The approach I have decided to take is to see how the banks ranked across the various matrix – 1 being the best and 11 being the worst.
This is a layman's approach so I decided to call it Understanding Nigerian Banks – Dummy's guide for this Sales Man (Don't Judge me)
After my exercise – see how the banks ranked using my cumulative points system

Banks	Earnings	PBT	PAT	RoE	CAR	Liquidity	T. Assets	CTI	CoF	NIM	CoR	NPL	Sum Total	Rank
Guaranty Trust	6	1	1	1	2	4	6	1	2	1	1	2	28	1st
Zenith	2	2	2	3	5	2	2	4	9	4	7	4	46	2nd
UBA	5	3	3	4	6	6	4	5	5	7	3	3	54	3rd
Access Bank	4	4	4	5	4	5	5	7	8	9	2	1	58	4th
FBN Holdings	3	6	6	7	8	3	3	3	4	2	10	11	66	5th
Stanbic	8	7	7	2	3	1	10	2	1	8	11	7	67	6th
Ecobank	1	5	5	6	1	11	1	6	6	11	9	9	71	7th
Diamond	7	8	8	9	10	8	7	8	3	10	8	10	96	8th
Fidelity	9	9	10	8	7	9	9	9	11	6	4	6	97	9th
Union Bank	11	10	9	10	11	7	8	10	7	3	5	8	99	10th
FCMB	10	11	11	11	9	10	11	11	10	5	6	5	110	11th

**** Earnings means Gross Earnings**

How profitable are your earnings?

For the 1H reporting – one set of numbers that stood out for me was GTBank. They reported earnings of NGN214bn with PBT of NGN101bn. The next best reported number was Stanbic IBTC Holdings with NGN97bn of earnings and PBT of NGN29bn. For GTBank, Profitability was 47% of its headline numbers versus Stanbic IBTC Holding and Zenith Bank with 30% and 24% of their headline number.

Without doing a deep dive – these are the initial points of attraction

Key Indicators	GTB	Zenith bank	UBA	Access Bank	FBN Holdings	Stanbic	Diamond	Fidelity	Union Bank	FCMB
Gross Earnings	214	380	222	246	288	97	114	85	73.7	77.5
PBT	101	92	57	52	35.6	29.2	10.8	10.2	9.5	3.8
PAT	83.7	75	42	39	29.5	24.1	9.3	9	9.2	3
Profitability as a % of Revenue	47%	24%	26%	21%	12%	30%	9%	12%	13%	5%

**** Profitability as a % of Revenue – we use PBT**

The quality of earnings? Traditional Banking or Exotic FX Swaps and Derivative?

In recent times, we have seen a few banks enter into FX swaps with the Sovereign, which has been a big driver of the FX trading income recorded in the books of some of the banks. Clients generally feel this income line is volatile, not sustainable and find it very difficult to forecast.
From some of our client discussions, where a bank has entered into FX swaps with a Sovereign, which is rated highly from a risk perspective, the bigger concerns around these FX Swaps and Derivative *(it is my job to worry on behalf of my clients)*

- The Sovereign is also the regulator – in which case, what is the bank's bargaining power with your regulator?
- As we approach an election year (2019), what are the maturity dates of these securities?
- What happens if the Sovereign requests for these securities to be rolled over at maturity as we approach an election?

These are some of the concerns around these FX swaps and derivatives

When the high interest rate environment disappears, who can create risk assets?

Given the high yields on government bills, banks have stayed away from lending as we have seen government crowding out the private sector lending. This has also put banks under pressure as savvy customers would rather invest their cash deposits in treasury bills, which is reflected in the funding cost pressures that we have seen across some of the banks. I don't believe interest rate levels will remain elevated over the medium term. When interest rates correct to the downside, which Banks will be in a position to grow its loan book? Most of the tier-1 banks currently have a lot of headroom to grow their respective loan books with tier-2 players closer to the regulatory limit of 15%.

Key Indicators	Access Bank	UBA	GTB	Zenith bank	Union Bank	FCMB	Stanbic	Diamond	Fidelity	FBN Holdings
Capital Adequacy	21.6	20	23.1	21	15	17.3	22.9	15.4	18.4	17.6
Liquidity Ratio	45.4	42	48.52	61	37	30	90	35.9	30.2	50.4

Going Digital is the Future? Having 500 Branches is no longer fashionable

With a relatively younger population and changing landscape in terms of how banks will operate, the future is digital banking where banks push their products to the customers via their technology platforms. Once upon a time, it was an interesting investment case to tell an investor that we wanted to double our branch network to capture cheap deposits. Permit me to use GTB and Diamond Bank as examples – with 218 and 279 branches (respectively) with strong retail and SME penetration, I would argue that no bank needs more than 300 branches (and I still think this is high) in the current market environment. Banks need to become more efficient and nibble and invest for the future. The relatively low branch network of GTB with strong brand visibility speaks to the lowest cost – to – income ratio in the market and in addition to that, the lowest cost of fund ratio in the market

Key Indicators	Access Bank	UBA	GTB	Zenith bank	Union Bank	FCMB	Stanbic	Diamond	Fidelity	FBN Holdings
Cost to income	62.7	58.6	40	56.7	68.7	70	47	62.7	67.3	54.4
Cost of Funds	6	3.6	2.9	6.4	5.7	6.8	2	3.2	7.5	3.5

Over the next 5 years – will the sector consolidate further by market share?

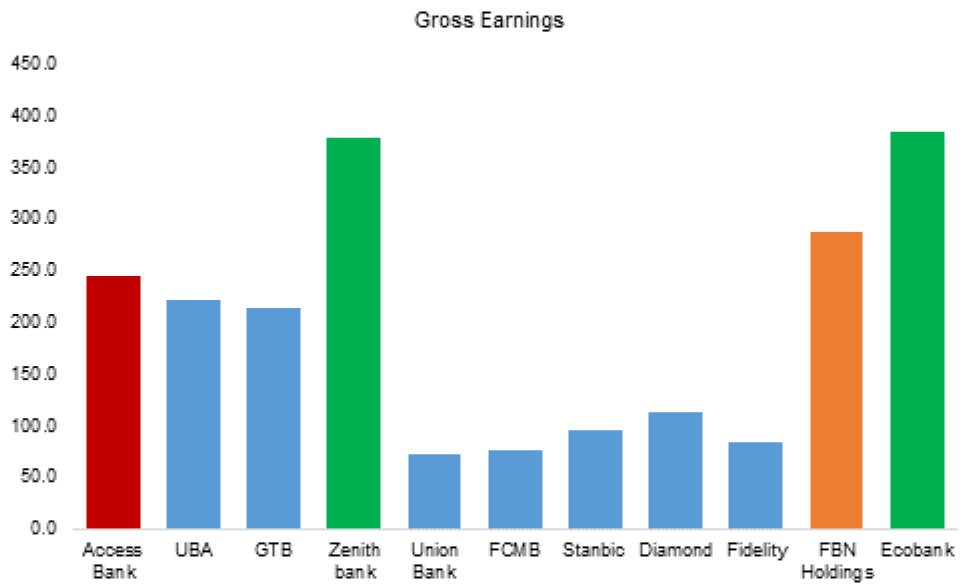
The tough economic backdrop and the recession has ultimately come and gone but left casualties. These casualties are reflected in the NPL tick-up in the banking sector over the last 24 months. I believe that going forward, banks will continue to grapple with NPLs which may or may not crystallize and also look for ways to resolve NPLs that have already crystallized. For certain players that are close to the regulatory limit from a CAR and Liquidity perspective – the obvious solution would be raising Capital. In the current environment, debt funding isn't particularly cheap and I do not believe that banks have the appetite to grow their FCY loans further as I struggle to understand where they would deploy such funds to, which is why you see a lot of banks entering into FX swaps with the Sovereign.

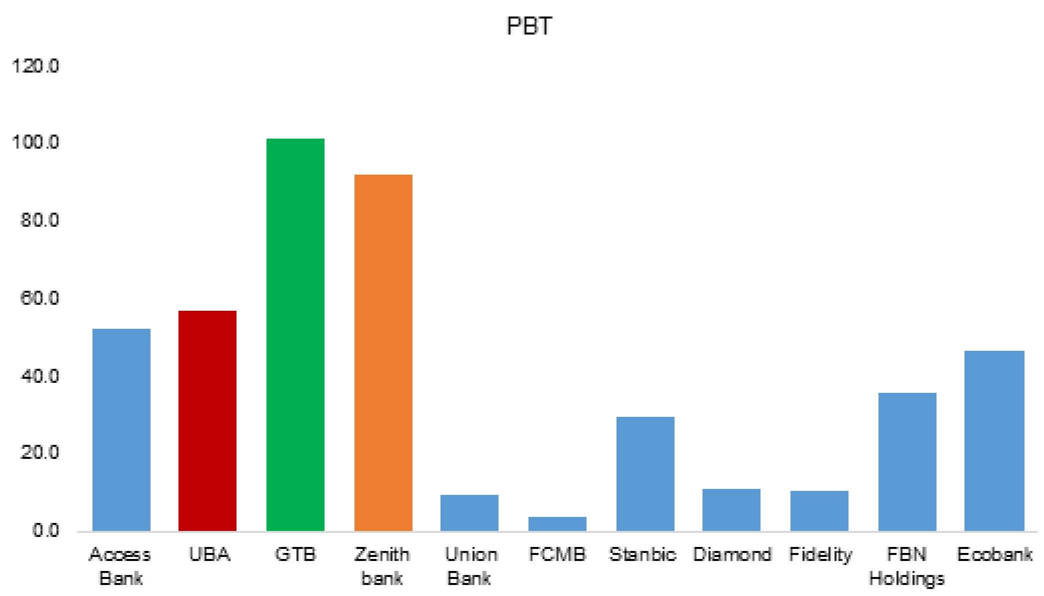
Away from that – Bank would happily look to raise tier 1 capital but with the exception of a few banks that trade above 1x P/B – Tier 1 Capital raise today is extremely dilutive to existing shareholders and I do not even believe there is appetite out there for investors to participate in tier 1 capital raise for banks grappling with low CAR, Liquidity ratio, elevated NPLs and Low ROE stories. (you can break the line, also not sure banks trading below book will really be happy to raise capital at such valuations ideally if they are not under pressure, they will prefer a higher valuation)

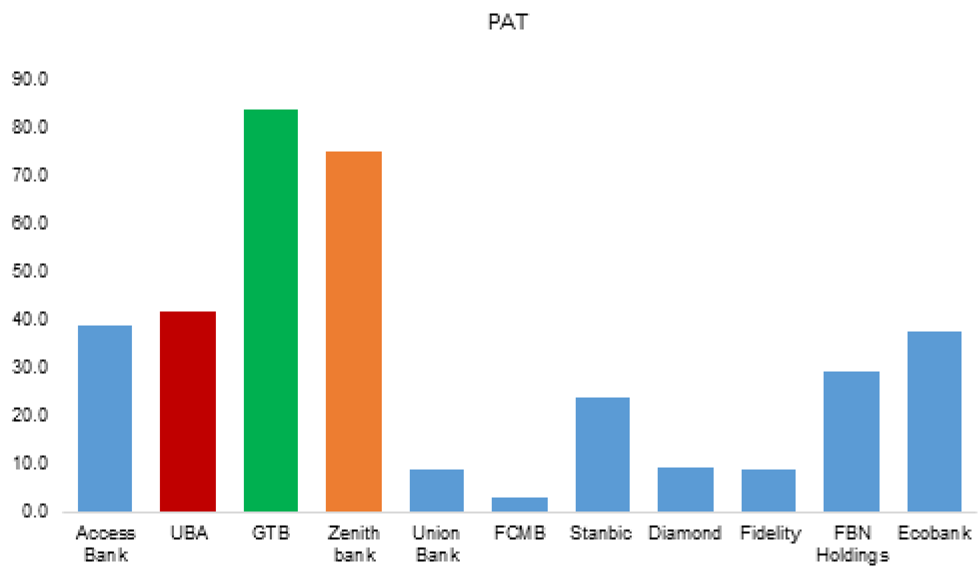
So what do you do? The banks could focus on resolving their loan books and wind down loans when they mature in order to to shore up the capital position of the bank as a last resort. Whilst the management of a bank is grappling with all these issues, when interest rates drop and the appetite to grow risk assets returns, other banks would be eating your lunch.

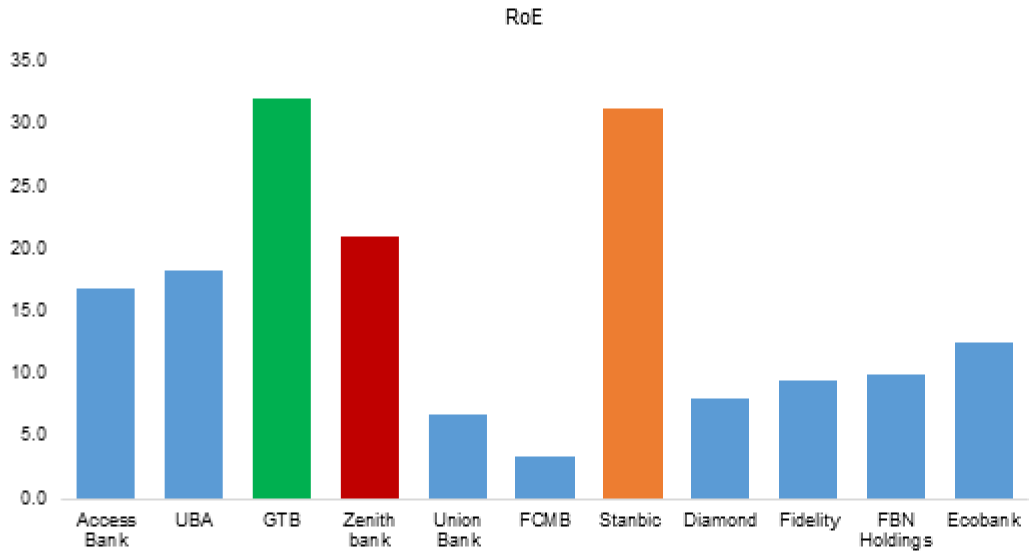
I think 5 years from now – all things being equal – the Nigerian-banking sector will consolidate itself by market share from an asset perspective where 7 – 8 big banks (something similar to the South African Banking industry) would emerge and other banks become too small as a percentage of total banking system assets. If you have a long view on Nigeria, select your names carefully and stick with them.

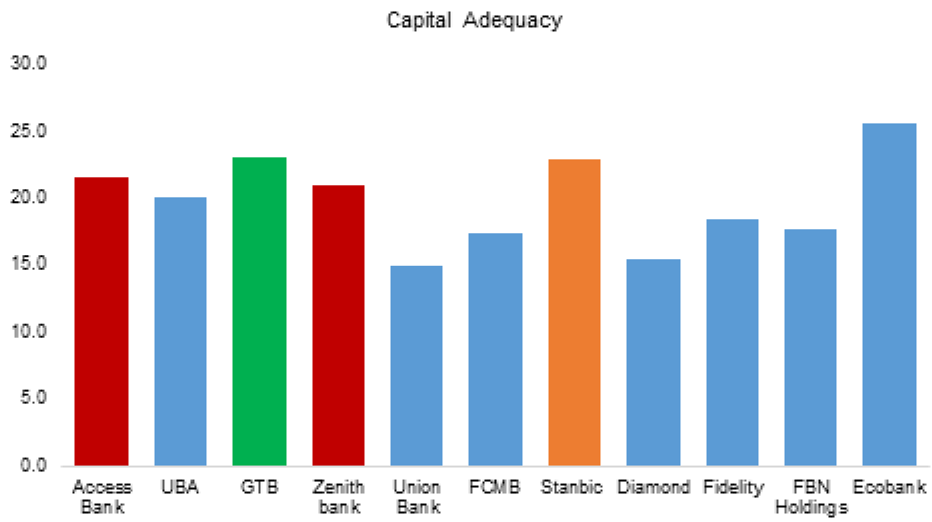
Key Indicators	Access Bank	UBA	GTB	Zenith bank	Union Bank	FCMB	Stanbic	Diamond	Fidelity	FBN Holdings
Cost of Risk	1.1	1.2	0.45	3.6		2.8	7.3	3.8	1.3	5.4
NPL ratio	2.5	4.2	3.71	4.3	8.2	4.7	7.8	10.5	5.8	22




PBT
120.0
100.0
80.0
60.0
40.0
20.0
0.0
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank


PAT
90.0
80.0
70.0
60.0
50.0
40.0
30.0
20.0
10.0
0.0
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank


RoE
35.0
30.0
25.0
20.0
15.0
10.0
5.0
0.0
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank


Capital Adequacy
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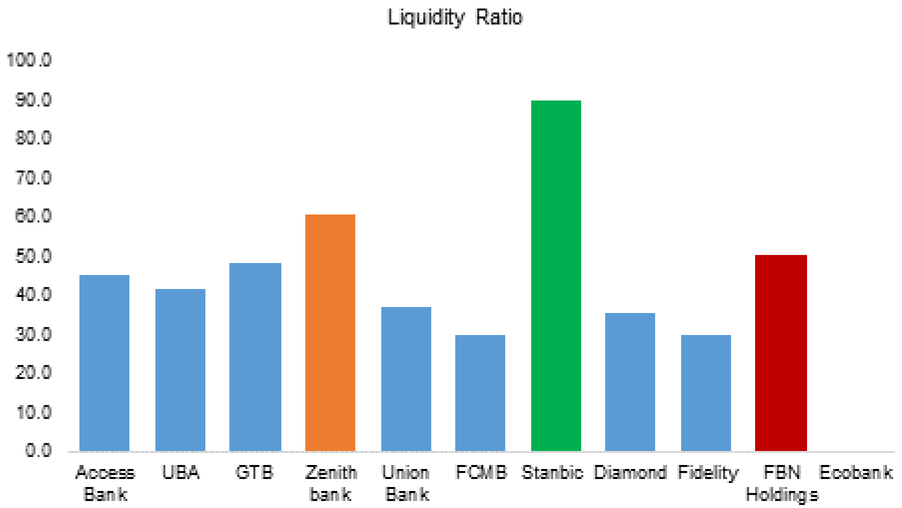
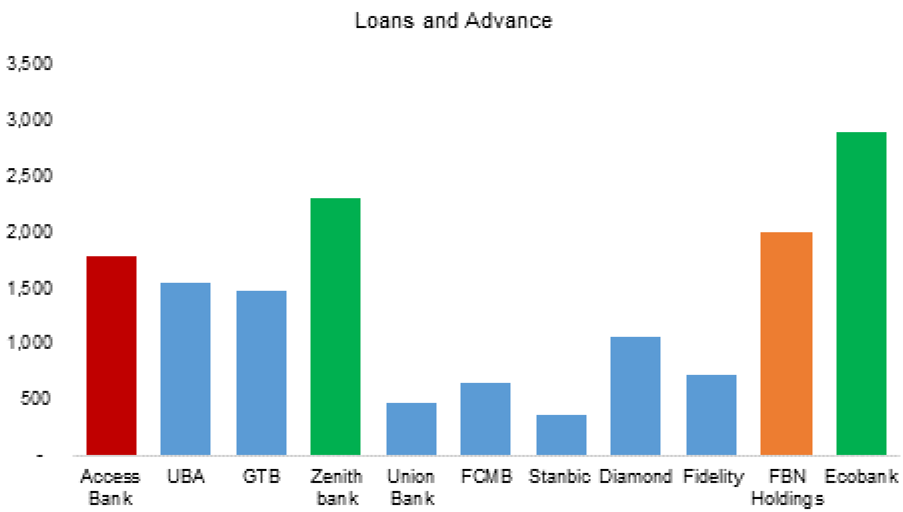
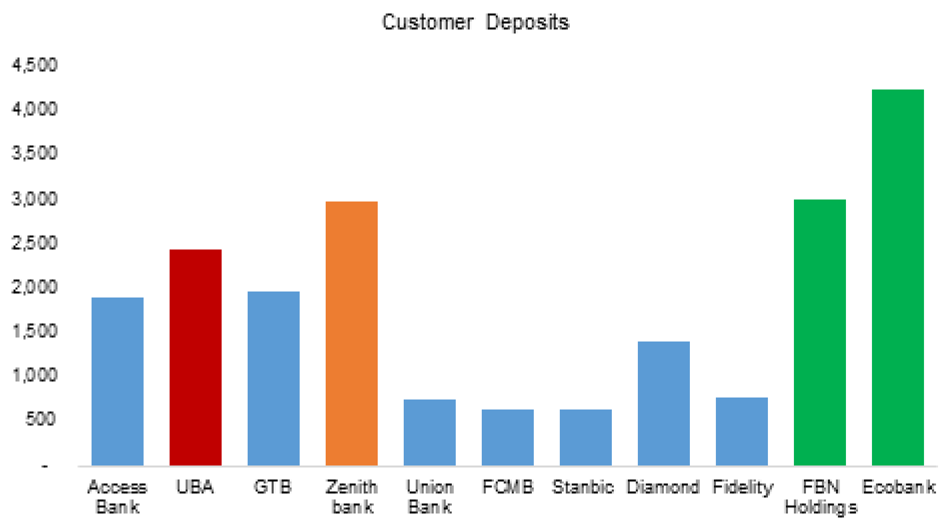
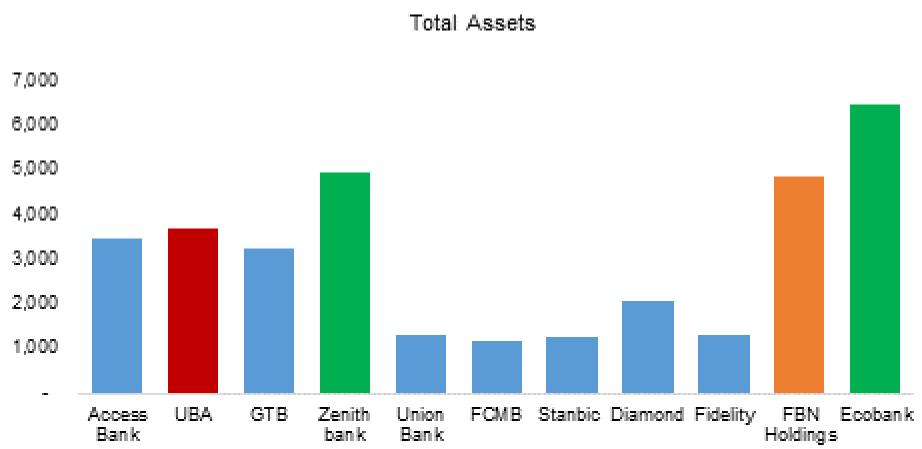
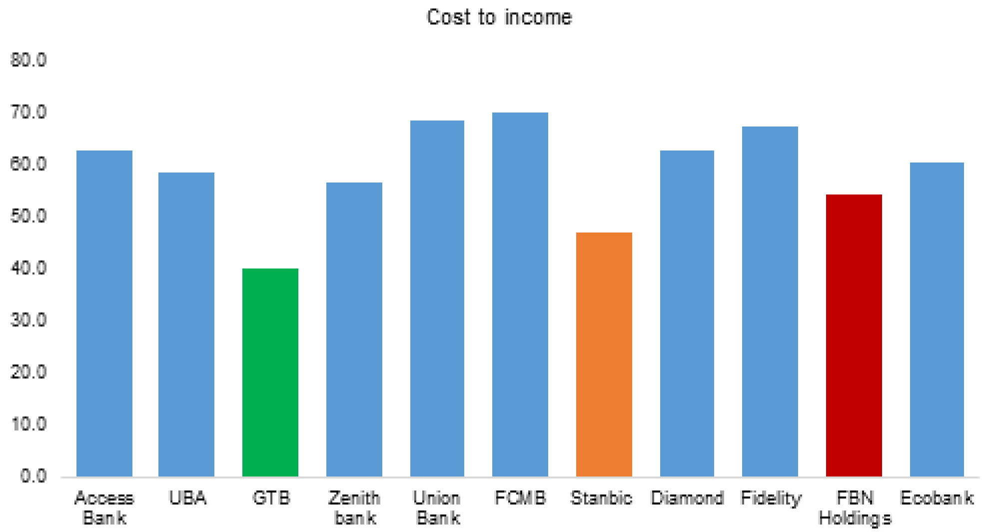
25.0
20.0
15.0
10.0
5.0
0.0
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank


Liquidity Ratio
100.0
90.0
80.0
70.0
60.0
50.0
40.0
30.0
20.0
10.0
0.0
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank


Loans and Advance
3,500
3,000
2,500
2,000
1,500
1,000
500
-
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank


Customer Deposits
4,500
4,000
3,500
3,000
2,500
2,000
1,500
1,000
500
-
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank


Total Assets
7,000
6,000
5,000
4,000
3,000
2,000
1,000
-
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank


Cost to income
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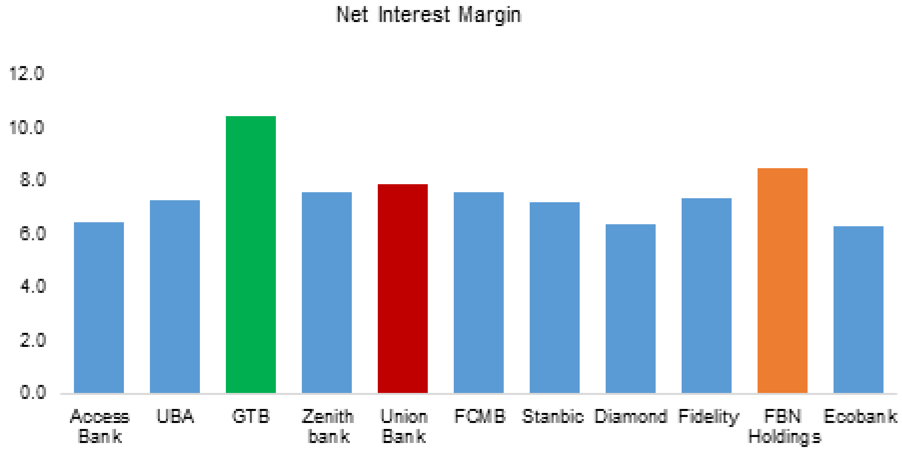
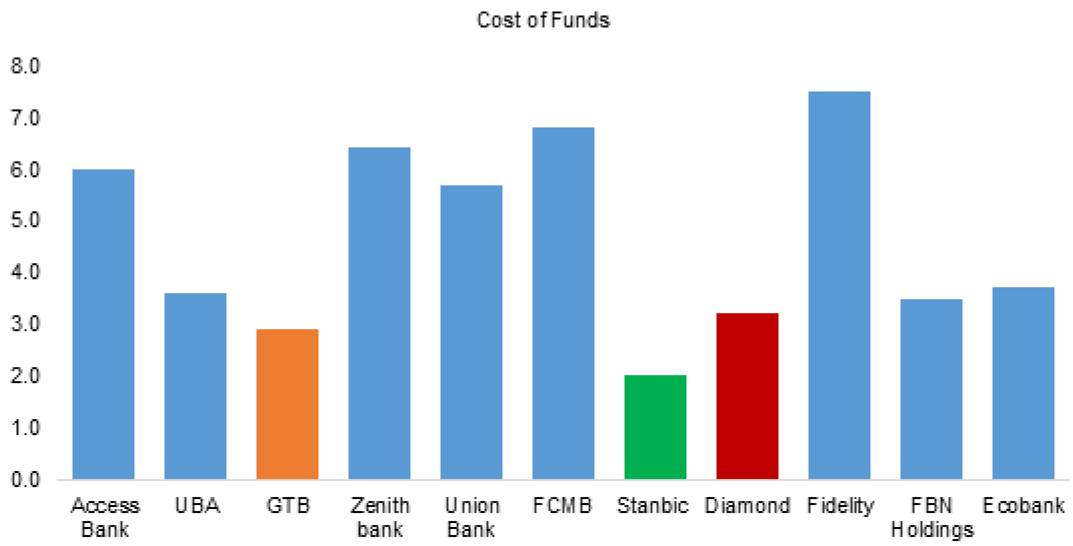
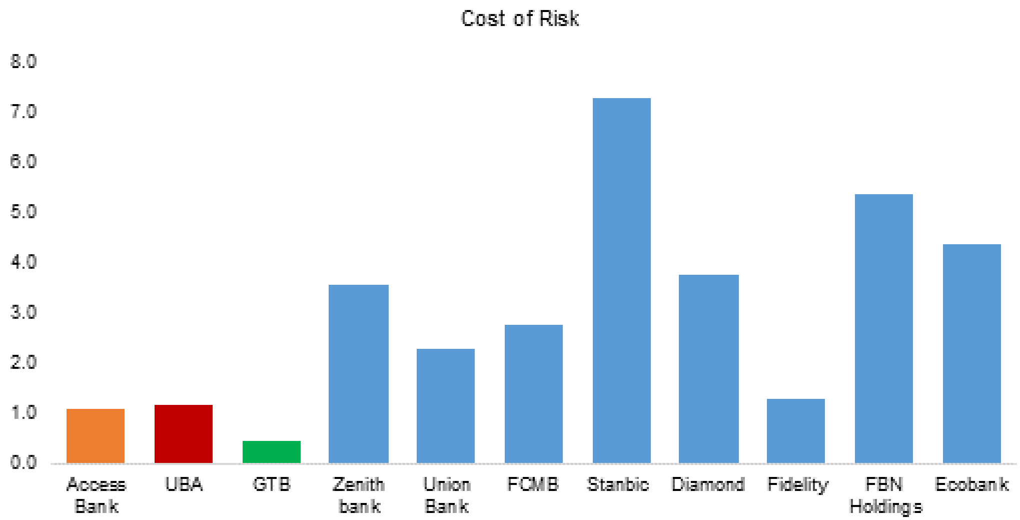
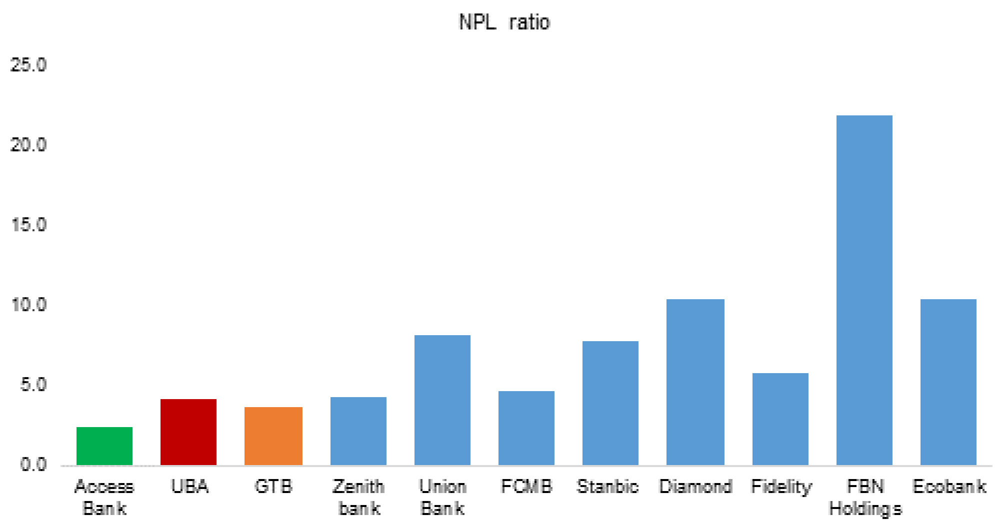
70.0
60.0
50.0
40.0
30.0
20.0
10.0
0.0
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank


Net Interest Margin
12.0
10.0
8.0
6.0
4.0
2.0
0.0
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank


Cost of Funds
8.0
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank


Cost of Risk
8.0
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank



NPL ratio
25.0
20.0
15.0
10.0
5.0
0.0
Access Bank
UBA
GTB
Zenith bank
Union Bank
FCMB
Stanbic
Diamond
Fidelity
FBN Holdings
Ecobank