Guaranty Trust Bank Plc

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Efficient Cost Management and Higher Non-Interest Income Buoy Profitability

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Price:	
- Current	**₦26.90**
- Target	**₦45.83**
Recommendation:	**STRONG BUY**

** As at Tuesday September 3, 2019*

INVESTMENT SUMMARY

The six-month to June 2019 audited financial statements released by Guaranty Trust Bank showed a slight setback in its top-line as gross earnings declined by 2.10% to ₦221.87 billion (vs. ₦226.63 billion in the six-month to 2018). The setback in gross earnings can be largely attributed to the fall in interest income during the period. Interest income declined by 7.96% to ₦148.99 billion in H1'19 (vs. ₦161.88 billion reported in H1'18), due to lower yield and dip in average volume of earnings assets. However, non-interest income increased significantly by 12.55% to ₦72.88 billion in H1'19 (vs. ₦64.75 billion reported in H1'18), mainly as a result of growth recorded on the fees and commission income line. Interest expenses fell by 25.76% to ₦32.63 billion in H1'19 (vs. ₦43.95 billion in H1'18) as the bank benefited from improved low cost deposit mix, full impact of cost savings from Eurobond redemption in November 2018 and repayment of expensive USD borrowed funds. However, operating expenses and impairment charges were almost flat at ₦69.87 billion (H1'18: ₦69.57 billion) and ₦2.19 billion (H1'18: ₦2.03 billion) in H1'19 respectively.

The impressive non-interest income and cost optimisation strategies reflected on profit before tax as it increased by 5.61% to ₦115.79 billion in H1'19 (vs. ₦109.63 billion in H1'18). A tax provision of ₦16.65 billion was made (H1'18: ₦14.05 billion) and as a result profit after tax rose modestly by 3.72% to ₦99.13 billion in H1'19 (vs. ₦95.58 billion in H1'18). Consequently, 12-month trailing EPS increased by 4.66% to ₦6.39, from ₦6.11 recorded in the previous period. The bank rewarded the shareholders with interim dividend of ₦0.30 per share which shall be paid on September 11, 2019. Based on the recent figure released by the company, we maintain a **BUY recommendation** on the company's shares at the current price of ₦26.90 as present forward estimate places the company share price at ₦45.38 (Previous target price: ₦46.35).

Fig. 1: Quarterly results highlights

	2Q2019	1Q2019	2Q2018	Q/q Δ	Y/y Δ
Net Int. Income (₦'mn)	58,148	58,217	58,241	-0.12%	-0.16%
PBT (₦'mn)	58,802	56,985	57,008	+3.19%	+3.15%
Net profit (₦'mn)	49,830	49,303	50,912	+1.07%	-2.13%

Source: NSE, PAC Research

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-21.92%/-25.28%
52-week range	₦39.15 - ₦25.70
30-day Average vol.	24,893,100
Shares Outstanding ('mn)	29,431.18
Market Cap. (₦bn)	791.70
EPS (₦) - 12months trailing	6.39
DPS (₦) - FY2018	2.75

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	H1'19	H1'18
Net Interest Margin	9.55%	9.61%
Net profit margin	44.68%	42.17%
Equity multiplier	5.97x	7.14x
Cash/ total Assets	24.12%	23.42%

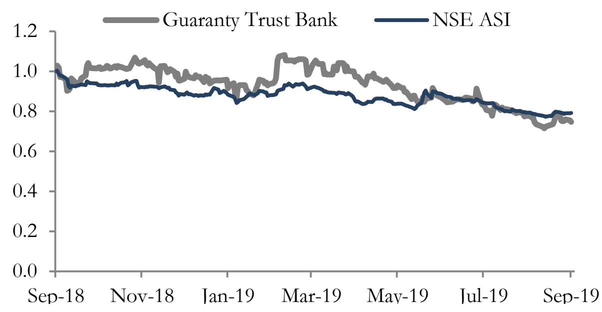
Source: NSE, PAC Research

Fig. 4: Valuation

	FY2017	FY2018	FY2019E	FY2020F
P/E	4.64x	4.29x	4.08x	3.68x
P/B	1.28x	1.38x	1.38x	1.28x
Div Yield (%)	10.04	10.22	10.41	10.59
Payout Ratio	46.61%	43.83%	42.45%	38.95%
Ev/Revenue	1.15%	0.69%	0.69%	0.58%
Rev per share	14.24	14.77	14.92	15.89
ROE	27.11%	32.08%	33.75%	34.70%
ROA	5.09%	5.62%	6.04%	6.29%

Source: NSE, PAC Research

Fig. 5: GTB vs NSE, 52-wk Movement (Rebased)



Source: Bloomberg, PAC Research

Gross earnings declines by 2.10% YoY, driven by lower interest income: In the period under review, Guaranty Trust Bank reported a setback in the top-line as gross earnings fell slightly by 2.10% to ₦221.87 billion (vs. ₦226.63 billion reported in the corresponding period of previous year). The lower gross earnings during the first half of 2019 can be mainly ascribed to the significant fall in interest income. Interest income generated by the bank declined by 7.96% to ₦148.99 billion in H1'19 (vs. ₦161.88 billion recorded in H1'18), due to declining yield environment and dip in average volume of earnings assets. However, with improvement in fees and commission income, the bank reported an impressive figure for non-interest income as it rose significantly by 12.55% to ₦72.88 billion in the six-month to June 2019 (vs. ₦64.75 billion in the six-month to June 2018). The 7.96% decline in interest income completely offset the gains of 12.55% recorded in the non-interest income line and this lowers the figure for top-line in the first half of 2019, when compared with the corresponding period of the previous year.

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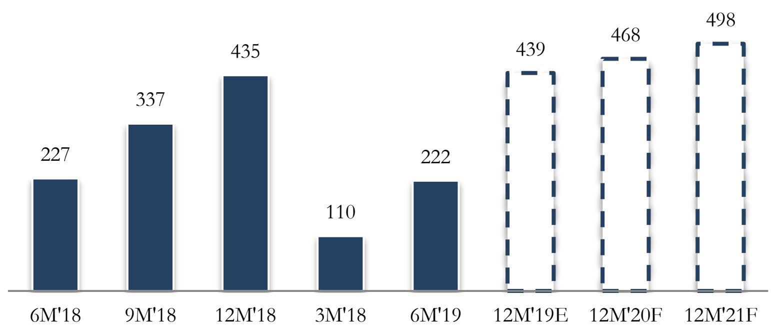
Fig. 6: Grosss Earnings – 6M'18-12M'21F (Billion NGN)



Source: NSE, PAC Research

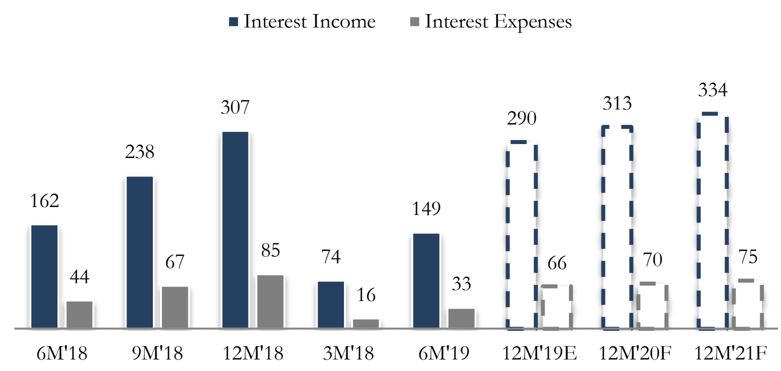
With lower yield and dip in average volume earning assets, interest income fall by 7.96% YoY: In the first half of 2019, Guaranty Trust Bank Plc reported a substantial lower figure for total interest income as it fell by 7.96% to ₦148.99 billion (vs. ₦161.88 billion in the first half of 2018). The lower figure for total interest income can be attributed to the declining yield environment in Nigeria and dip in average volume of earning assets in the first half of 2019. Portfolio yield on treasury bills fell by 180bps to 15.60% (vs. 17.40% in H1'18) while yield on local currency (LCY) risk assets declined by 70bps to 16.10% in H1'19 (vs. 16.80% in H1'18). As result, earnings asset yield fell by 101bps to 12.06% in H1'19 (vs. 13.07% in H1'18). In addition, the bank recoded a dip in the average volume of earning assets which fell by 4.30% to ₦2.06 trillion in H1'19 (vs. ₦2.12 trillion in H1'18) as a result of scheduled pay-down on foreign currency (FCY) term loans whose average volume fell by 4.70% to ₦656.50 billion (H1'18: ₦688.90 billion).

The lower figure for total interest income can be attributed to the declining yield environment in Nigeria and dip in average volume of earning assets in the first half of 2019.

The dip lower yield environment and dip in average volume earning assets reflected on interest income from loans & advances to customers and interest income from investment securities as they declined by 9.97% and 9.09% to ₦87.42 billion (H1'18: ₦97.09 billion) and ₦46.49 billion (H1'18: ₦51.14 billion) respectively.

However, total interest expenses declined by 25.76% to ₦32.63 billion in H1'19 (vs. ₦43.95 billion reported in H1'18) as the bank benefitted from improved low cost deposit mix, full impact of cost savings from Eurobond redemption in November 2018 and repayment of expensive USD borrowed funds. The low cost deposit mix reflected on lower interest expenses on deposit from customers which declined by 22.68% to ₦26.73 billion in H1'19 (vs. ₦34.57 billion in H1'18). Consequently, net interest income fell slightly by 1.33% to ₦116.37 billion in H1'19 (vs. ₦117.93 billion in H1'18).

Fig. 7: Int. Income and Int. Expenses: 6M'18-12M'21F (Billion NGN)



Source: NSE, PAC Research

Non-interest income rises by 12.55% YoY due to higher fee and commission income: Guaranty Trust Bank reported impressive figure for non-interest income as it increased by 12.55% to ₦72.88 billion in six-month to June 2019 (vs. ₦64.75 billion recorded in six-month to June 2018), mainly as a result of higher fee & commission income, significant income from recoveries and substantial income from discounts and recoverables (FX). As a result of higher credit related fees and commissions, improved corporate finance fees, higher e-business income and increased commission on foreign exchange deals, total fee and commission increased by 29.22% to ₦35.35 billion in H1'19 (vs. ₦27.36 billion in H1'18).

However, operating expenses of the bank remains almost flat at ₦69.87 billion in H1'19 (vs. ₦69.57 billion reported in H1'18), due to consistent application of cost optimisation strategies which helped in achieving 0.43% growth in OPEX (which is far below inflation rate of 11.22% for the month of June 2019). The outcome of cost optimisation strategies resulted in lower cost-to-income ratio of 37.60% (H1'18: 38.80%).

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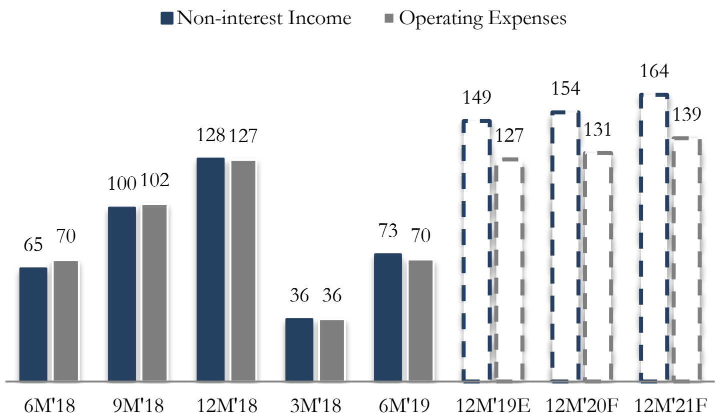
Fig. 8: Non-Int. Income and Operating Expenses: 6M'18-12M'21F (Billion NGN)

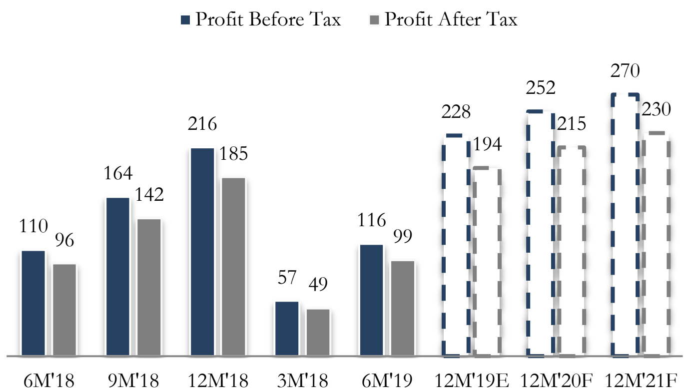


Source: NSE, PAC Research

Higher non-interest income and efficient cost management mirror on higher profitability: The bank maintain a consistent improvement in loan impairment charges in the first half of 2019. A provision of ₦2.19 billion was made for loan impairment charge in the period under review (vs. ₦2.03 billion in the corresponding period of the previous year). With relatively moderate impairment charge, higher non-interest income and efficient cost management, profit before tax increased by 5.61% to ₦115.79 billion in H1'19 (vs. ₦109.63 billion in H1'18). However, the bank made a provision of ₦16.65 billion for tax in the first half of 2019 (vs. ₦14.05 billion in the first half of 2018), representing an increase of 3.72% year-on-year. Consequently, profit after tax increased by 3.72% to ₦99.13 billion in H1'19 (vs. ₦95.58 billion in H1'18). Impressively, 12-month trailing EPS increased by 4.66% to ₦6.39, from ₦6.11 recorded in the previous period. The bank rewarded the shareholders with interim dividend of ₦0.30 per share which shall be paid on September 11, 2019.

With relatively moderate impairment charge, higher non-interest income and efficient cost management, profit before tax increased by 5.61% to ₦115.79 billion in H1'19…

Fig. 9: Profit before Tax and Profit after Tax – 6M'18-12M'21F (Billion NGN)



Source: NSE, PAC Research

Balance sheet remains solid and strong: expectation of impessive final dividends in FY'19: The balance sheet position of Guaranty Trust Bank remains strong and solid in the first half of 2019 as total assets increased by 1.39% to ₦3.60 trillion (vs. ₦3.55 trillion in the first half of 2018). The improved total asset can be mainly attributed to higher cash & cash equivalents, improved investment securities and higher property & equipment. In addition, the total liabilities of the bank declined by 1.86% to ₦2.30 trillion in H1'19 (vs. ₦3.05 trillion in H1'18), due to lower derivative financial liabilities, depressed current income tax liabilities and other borrowed funds. As a result, total equity increased significantly by 21.31% to ₦603.01 billion (vs. ₦497.08 billion in H1'18) and this resulted in a higher net asset per share of ₦20.49 in H1'19, compared to ₦16.89 in the corresponding period of the previous year.

The capital adequacy ratio and liquidity ratio of the bank are well above the regulatory requirement of 16% and 30% respectively. In the first half of 2019, capital adequacy ratio closed at 23.48%, relative to 23.39% in the corresponding period of the previous year while liquidity ratio closed at 47.25%, compared with 41.44% in the first half of 2018. The bank's loans to deposits ratio of 49.94% in H1'19 (H1'18: 53.55%) fall short of new CBN regulatory requirement of 60.00% (effective September 1, 2019). However, this is not an issue for the bank in the first half of 2019 as we expect the bank to meet the of 60.00% loans-to-deposit ratios requirement of CBN.

Having rewarded the shareholders with impressive interim dividend of ₦0.30 in the first half of 2019 (first half of 2018: ₦0.30), we expect the bank to pay impressive final dividend in the full year of 2019.

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Fig. 10: Total Liabilities Vs Net Asset in H1'19

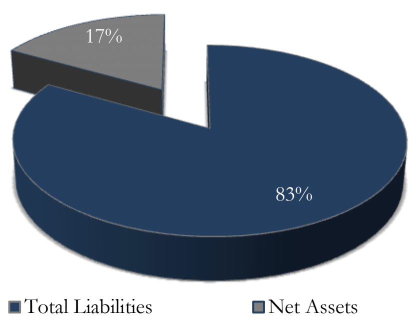
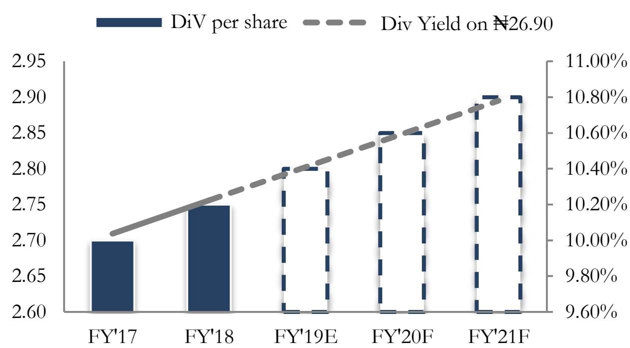


Fig. 11: Dividend Per Share and Dividend Yield (FY'17-FY'21F)



Source: NSE, PAC Research

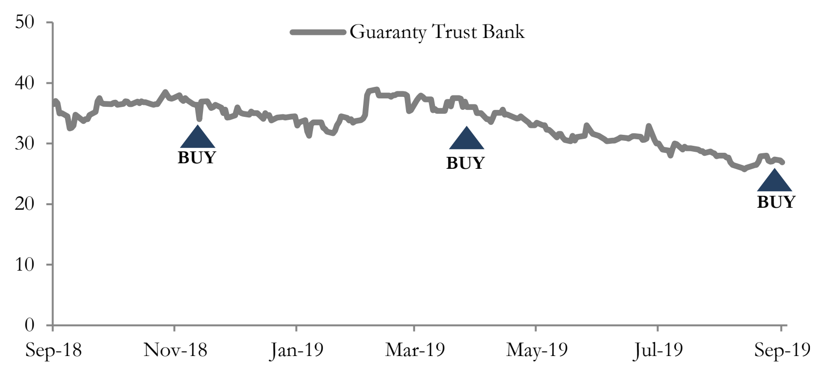
Valuation

Our valuation puts the target price of the stock at ₦45.83, representing an increase of 70.38% from the current price of ₦26.90. In arriving at the target price, we employed Residual Income Model. Consequently, we maintain a **BUY** recommendation on the stock of the company.

Our valuation and forecasts considered several factors (both quantitative and qualitative) among which are; the previous financial reports of the company, the current figures released by the company and the performance of the bank in the banking industry

Our valuation puts the target price of the stock at N45.83, representing an increase of 70.38% from the current price of N26.90.

Fig. 12: Share Price History (Naira)



Source: NSE, PAC Research

Fig. 13: Statement of Profit or Loss, N'mn

	2017	2018	2019E	2020F
Gross Earnings	419,226	434,699	439,002	467,538
Change		3.69%	0.99%	6.50%
Interest and Similar Income	327,334	306,963	289,742	313,250
Change		-6.22%	-5.61%	8.11%
Interest and Similar Expenses	-80,670	-84,530	-65,850	-70,131
Change		4.78%	-22.10%	6.50%
Net Interest Income	246,663	222,434	223,891	243,120
Change		-9.82%	0.66%	8.59%
Impairment Charge for credit losses	-12,169	-4,906	-5,268	-5,610
Change		-59.68%	7.37%	6.50%
Net Fees and Commission Income	40,732	50,470	63,260	67,325
Change		23.91%	25.34%	6.43%
Trade gains	11,339	24,584	18,219	19,403
Change		116.81%	-25.89%	6.50%
Personnel expenses	-32,832	-36,856	-36,437	-38,806
Change		12.26%	-1.14%	6.50%
Profit Before Taxation	197,685	215,587	227,623	252,470
Change		9.06%	5.58%	10.92%
Taxation	-29,772	-30,947	-33,483	-37,138
Change		3.95%	8.20%	10.92%
Profit After Taxation	167,913	184,640	194,139	215,332
Change		9.96%	5.15%	10.92%

Fig. 14: Statement of Fin. Position, N'mn

	2017	2018	2019E	2020F
Cash and cash equivalents	641,974	676,989	684,844	729,359
Loans and advances	1,449,284	1,262,005	1,188,380	1,265,624
Financial assets held for trading	23,946	11,315	17,560	18,702
-Available for Sale/fair value tru other compr. Income	517,493	538,705	548,753	584,422
Held to Maturity	96,467	98,620	109,751	116,884
Assets pledged as collateral	58,976	56,777	58,826	62,650
Loans and advances to banks	750	2,995	3,073	3,273
Loans and adv. to customers	1,448,533	1,259,010	1,185,307	1,262,352
Property and equipment	98,670	111,826	105,361	112,209
Restr. deposits & other assets	444,947	508,679	478,513	509,616
Total Assets	3,351,097	3,287,343	3,214,245	3,424,012
Deposits from banks	85,431	82,803	76,825	79,481
Deposits from customers	2,062,048	2,273,903	2,203,792	2,347,039
Other liabilities	224,117	140,448	136,091	140,261
Deferred tax labilities	18,076	7,786	18,789	20,011
Debt securities issued	92,132	0	0	0
Other borrowed funds	220,492	178,567	175,601	187,015
Total Liabilities	2,731,696	2,711,775	2,638,976	2,803,403
Net Assets	619,400	575,567	575,269	620,609
Total equity and liabilities	3,351,097	3,287,343	3,214,245	3,424,012

Fig. 15: Profitability Ratio

	2017	2018	2019E	2020F
Return on Equity	27.11%	32.08%	33.75%	34.70%
Return on Assets	5.09%	5.62%	6.04%	6.29%
Net interest income to Revenue	58.84%	51.17%	51.00%	52.00%
PBT margin	47.15%	49.59%	51.85%	54.00%
Net Profit Margin	40.05%	42.48%	44.22%	46.06%
ROCE	9.36%	10.09%	11.03%	11.57%

Fig. 16: Asset Utilisation

	2017	2018	2019E	2020F
Cash/Revenue	153.13%	155.74%	156.00%	156.00%
Revenue to total assets (x)	12.51%	13.22%	13.66%	13.65%
Interest Income / Total Assets	9.77%	9.34%	9.01%	9.15%
Loan Loss Exp./Net Int. Income	4.93%	2.21%	2.35%	2.31%
Loan Loss Exp./After Tax Profit	7.25%	2.66%	2.71%	2.61%
fixed asset turnover	23.54%	0.50%	0.65%	0.65%

Fig. 17: Liquidity Ratios

	2017	2018	2019E	2020F
Current ratio	1.23	1.21	1.22	1.22
Cash ratio	0.24	0.25	0.26	0.26
Interest Coverage ratio	2.45	2.55	3.46	3.60
Liquid Assets/Total Deposit	25.17	24.10	25.15	25.89
Loans &Advances/Total Deposit	6.06	6.51	7.14	7.35
Liquid Assets/Total Assets	0.64	0.61	0.60	0.60
Debt/net income	1.31	0.97	0.90	0.87
Debt to asset	0.07	0.05	0.05	0.05
Debt to equity	0.36	0.31	0.31	0.30
Total Liabilities / Total Asset	0.82	0.82	0.82	0.82
Cost to income ratio	0.25	0.26	0.26	0.25
net interest margin AVERAGED	0.10	0.10	0.09	0.08
Total liabilities/equities	4.41	4.71	4.59	4.52

Fig. 18: Shareholders' Investment Ratios

	2017	2018	2019E	2020F
Earnings per share	5.79	6.27	6.60	7.32
DiV per share	2.70	2.75	2.80	2.85
NAVPS	21.05	19.56	19.55	21.09
Earnings yield	21.53%	23.32%	24.52%	27.20%

Fig. 19: Capital Adequacy Ratios

	2017	2018	2019E	2020F
Loans and Advances/Equity	2.34	2.19	2.07	2.04
Equity/Total Assets	0.18	0.18	0.18	0.18
Loan Loss Expense/ Equity	0.02	0.01	0.009	0.009

Source: Company's Annual Reports, PAC Research

Equity research methodology employed in this report

Views documented in this equity research report stem from conclusions reached through the use of multiple valuation methodologies, industry-wide knowledge, company specific information and our near to medium term expectations of industry and company performance, as well as market outlook. Our forecasts are based on a combination of top down and bottom up analysis, alongside historical trends in industry and company financials. Where appropriate, we factored in available forecasts and business direction provided by company management.

Our recommendation tends towards value investing. Therefore, our investment rank gauge—a customized scale we use to judge how well a firm under coverage has performed—is determined using major value parameters as well as relevant ratios and multiples computed with figures from the company's most recent financials.

The variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profit margins, growth, economic viability, gearing, relative valuation ratios, capital structure and management performance. Our investment recommendation is underpinned by the upside or downside potential of a stock under coverage. This potential is estimated by comparing the stock's current market price to its price target and fair value, on a percentage increase or decrease basis as summarized below:

Deviation from current price	Recommendation
>30%	STRONG BUY
10% to < 30%	BUY
-10% to < 10%	HOLD
<-10%	SELL

IMPORTANT DISCLOSURES

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