

Regulatory Cut to Fees Continues to Bite into Non-Interest Income Line

INVESTMENT SUMMARY

The unaudited results of nine-month to September 2020 recently released by Guaranty Trust Bank showed an improved top-line as gross earnings rose by 1.20% to ₦329.95 billion (vs. ₦326.03 billion in nine-month to September 2019). In line with our projection, the slight development in the top-line was attributed mainly to interest income, which rose by 1.80% to ₦228.23 billion in 9M'20 (vs. ₦224.19 billion reported in 9M'19), due to higher income from the investment securities and loans & advances. However, the non-interest income line of the bank remains almost flat at ₦101.73 billion in 9M'20 (vs. ₦101.85 billion in 9M'19). The standstill in the non-interest income line in the nine-month to September 2020 was mainly ascribed to lower bank charges which resulted to lower fee and commission income. Impressively, the bank benefited from lower yields during the period as interest expense fell significantly by 24.90% to ₦38.49 billion (vs. ₦51.25 billion recorded in 9M'19). Meanwhile, total operating expenses increased by 12.85% to ₦112.40 billion in 9M'20 (vs. ₦99.60 billion in 9M'19). Also, in line with our forecast, loan impairment charge increased significantly by 267.35% to ₦10.15 billion in 9M'20 (vs. ₦2.76 billion in 9M'19).

As a result of lower fee & commission income, higher OPEX and higher loan impairment charges, profit before tax fell by 1.93% to ₦167.35 billion in 9M'20 (vs. ₦170 billion in 9M'19). The bank also made a higher tax provision of ₦25.07 billion in 9M'20 billion (vs. ₦23.66 billion in 9M'19). Consequently, profit after tax declined by 3.20% to ₦142.28 billion (vs. ₦146.99 billion in 9M'19). Impressively, the 12-month trailing EPS improved by 1.45% to ₦6.53, from ₦6.53 recorded in the previous period. Based on the recently released figures, we maintain a BUY rating on the stock at the current price of ₦33.25 as present forward estimate places the company share price at ₦36.94 (Previous target price: ₦30.06).

Fig. 1: Quarterly results highlights

	3Q2020	2Q2020	3Q2019	Q/q Δ	Y/y Δ
Net Int. Income (₦mn)	62,121	63,333	56,572	-1.91%	+9.81%
PBT (₦mn)	57,638	51,510	54,864	+11.90%	+5.06%
Net profit (₦mn)	48,012	44,204	47,856	+8.61%	+0.33%

Source: NSE, PAC Research

December 4, 2020

Oluwole Adeyeye

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Price:

- Current	₦33.25
- Target	₦36.94
Recommendation:	BUY

* As at Friday December 4, 2020

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+11.95%/+9.74%
52-week range	₦16.70 - ₦38.45
30-day Average vol.	18,294,770
Shares Outstanding ('mn)	29,431.18
Market Cap. (₦bn)	978.59
EPS (₦) - 12months trailing	6.53
DPS (₦) - FY2019	2.80

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	H1'20	H1'19
Net Interest Margin	9.48%	9.43%
Net profit margin	43.12%	45.08%
Equity multiplier	6.05x	5.53x
Cash/ total Assets	13.62%	17.82%

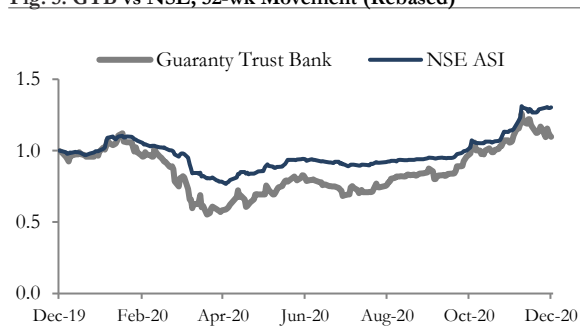
Source: NSE, PAC Research

Fig. 4: Valuation

	FY2018	FY2019	FY2020F	FY2021F
P/E	5.30x	4.97x	5.05x	4.73x
P/B	1.70x	1.42x	1.60x	1.53x
Div Yield (%)	8.27	8.42	8.42	8.57
Payout Ratio	43.83%	41.86%	42.52%	40.52%
Ev/Revenue	1.12x	1.28x	1.21x	1.11x
Rev per share	14.77	14.79	15.01	15.54
ROE	32.08%	28.64%	31.76%	32.36%
ROA	5.62%	5.24%	4.17%	4.31%

Source: NSE, PAC Research

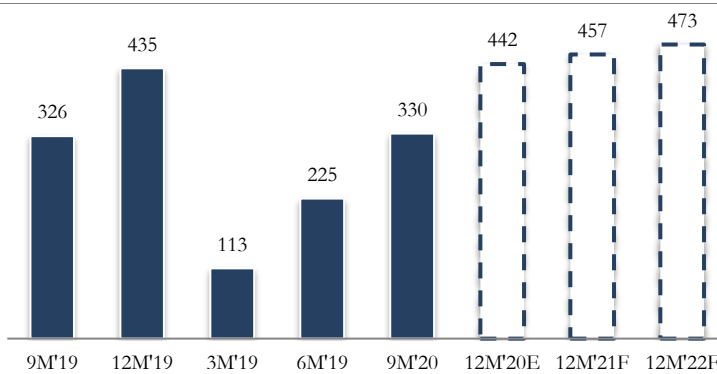
Fig. 5: GTB vs NSE, 52-wk Movement (Rebased)



Source: Bloomberg, PAC Research

Gross earnings rises by 1.20% year-on-year, boosts by interest income:

Despite the challenging operating environment, occasioned by the coronavirus pandemic which disrupted transaction volumes, coupled with pressure on asset yield and revision to bank charges in the nine-month to September 2020, Guaranty Trust Bank reported impressive top-line as the gross earnings of the bank increased by 1.20% to ₦329.95 billion in nine-month to September 2020 (vs ₦326.03 billion in nine-month to September 2019), mainly as a result of resilient improvement in the interest income line. The interest income of the bank increased by 1.80% to ₦228.23 billion in nine-month to September 2020 (vs. ₦224.19 billion in nine-month to September 2019). However, the figure for non-interest income line of the bank remained flat at ₦101.73 billion in 9M'20 (vs. ₦101.85 billion in 9M'19). In line with our projection, the stagnation of the non-interest line of the bank was mainly attributed to lower bank charges which resulted to depression of fee and commission income during the period.

Fig. 6: Gross Earnings – 9M'19 - FY'22F (Billion NGN)

Source: NSE, PAC Research

Due to improvement in the average volume of risk assets and fixed income securities, interest income improves by 1.80% year-on-year:

In line with our expectation, Guaranty Trust Bank Plc partially benefited from the higher loan-to-deposit ratio (as directed by the CBN) in the nine-month to September 2020 as interest income from loans and advances increased by 1.99% to ₦137.35 billion (vs. ₦134.67 billion in nine-month to September 2019). In addition, the bank also benefited from the long position taken in fixed income securities when yields were high as total interest income from investment securities increased by 4.05% to ₦70.50 billion in 9M'20 (vs. ₦67.76 billion in 9M'19). The improvement in interest income from loans & advances and investment securities result to higher total interest income as it increased by 1.80% to ₦228.23 billion in nine-month to September 2020 (vs. ₦224.19 billion in nine-month to September 2019).

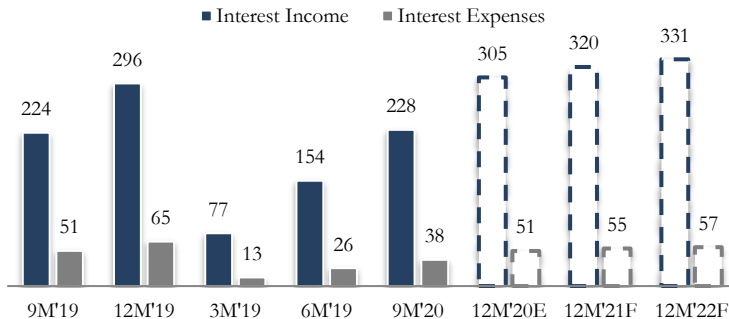
Impressively, interest expenses declined significantly by 24.90% to ₦38.49 billion during the period (vs. ₦51.90 billion in 9M'19), due to improvement in the cost of funds occasioned by the low-cost deposit, repricing of deposit rates and exiting of expensive tenured deposits during the period.

...the stagnation of the non-interest line of the bank was mainly attributed to lower bank charges which resulted to depression of fee and commission income during the period

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In addition, the bank's interest expense also gained from improved system liquidity which resulted from the restriction of individuals and non-banking corporates from investing in OMO treasury bills as placement with banks increased during the period.

Fig. 7: Int. Income, Int. Expenses and NII: 9M'19 – 12M'22F (Billion NGN)



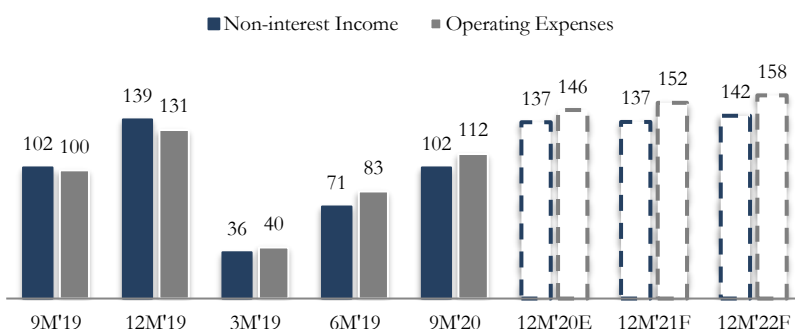
Source: NSE, PAC Research

Non-interest income remains relatively flat due to setback in fee and commission income: In the nine-month to September 2020, the non-interest income of the bank remained relatively flat at ₦101.73 billion (vs. ₦101.85 billion reported in the nine-month to September 2019). The stagnation of the non-interest income could be ascribed to the significant fall in fee and commission income during the period. Again, the reduction of bank charges by the Central Bank of Nigeria adversely impacted the fee and commission income as it fell significantly by 22.69% to ₦37.40 billion in nine-month to September 2020 (vs. ₦48.38 billion reported in nine-month to September 2019). However, the setback in the fee and commission income was offset by the benefit derived from the foreign exchange trading gain and this translated to stagnant non-interest income, when compared with corresponding period of previous year.

During the period, operating expenses of the bank increased by 12.85% to ₦112.40 billion (vs. ₦99.60 billion reported in the corresponding period of previous year), due to increase regulatory cost (AMCON levy and NDIC), rising inflation rate and increase in level of depreciation charges. The higher operating expenses resulted in cost-to-income ratio of 41.18% in 9M'20 (9M'19: 36.84%).

...the setback in the fee and commission income was offset by the benefit derived from the foreign exchange trading gain...

Fig. 8: Non-Int. Income and Operating Expenses: 9M'19 – 12M'22F (Billion NGN)

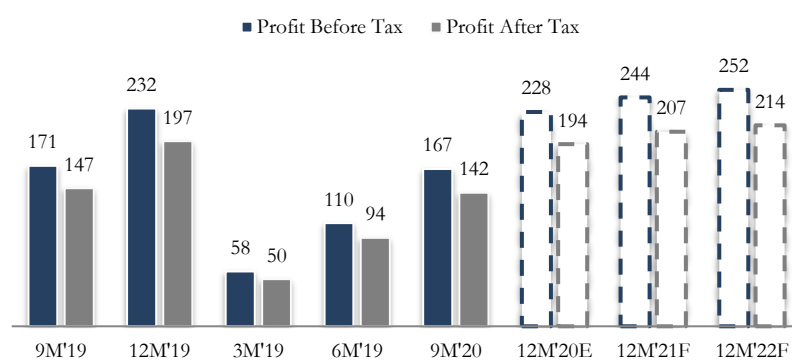


Source: NSE, PAC Research

With higher impairment charges, PBT falls by 1.93% year-on-year: In line with or projection, the loan impairment charges of the bank increased significantly by 267.35% to ₦10.15 billion in nine-month to September 2020 (vs. ₦2.76 billion in nine-month to September 2019). The increase in loan impairment charge reflected the heightened probability of default due to the impact of COVID-19 on macroeconomic variables which resulted in worsening forward-looking information which primarily drives IFRS 9 impairment numbers.

As a result of higher impairment charges and higher OPEX, profit before tax fell by 1.93% to ₦167.35 billion in 9M'20 (vs. ₦170.65 billion reported in 9M'19). The bank made a higher provision of ₦25.07 billion for tax during the period (9M'19: ₦23.66 billion) and as a result, profit after tax declined by 3.20% to ₦142.28 billion in 9M'20 (vs. ₦146.99 billion in 9M'19). This result makes Guaranty Trust Bank the second best performing listed bank, in terms of profit after tax, in Nigeria in nine-month to September 2020.

Fig. 9: Profit before Tax and Profit after Tax – 9M'19 – 12M'22F (Billion NGN)



Source: NSE, PAC Research

Balance sheet remains solid and strong: GTBank to maintain historical final dividend payment in FY'20:

The balance sheet position of Guaranty Trust Bank remains strong and solid in the third quarter of 2020 as total assets increased by 29.96% to ₦4.57 trillion (vs. ₦3.52 trillion in the third quarter of 2019). The improved total asset can be mainly attributed to improved loans & advances and higher restricted deposits & other assets. However, the total liabilities of the bank increased by 32.45% to ₦3.82 trillion in Q3'20 (vs. ₦2.88 trillion in Q3'19), mainly as a result of higher deposits and other liabilities during the period. As a result, the net assets of the bank increased significantly by 18.66% to ₦755.55 billion in Q3'20 (vs. ₦636.75 billion in Q3'19) and this resulted in a higher net asset per share of ₦25.67 in Q3'20 (vs. ₦21.64 in Q3'19).

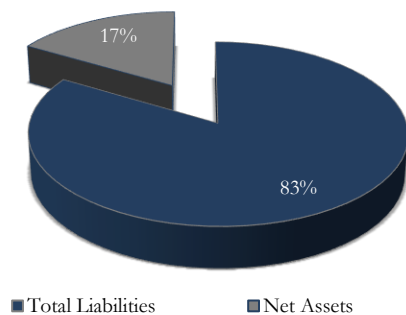
The capital adequacy ratio and liquidity ratio of the bank are well above the regulatory requirement of 16% and 30% respectively. In the third quarter of 2020, the capital adequacy ratio (Full IFRS 9 Impact) closed at 23.85% (vs. 22.51% in the third quarter of 2019).

The increase in loan impairment charge reflected the heightened probability of default due to the impact of COVID-19 on macroeconomic variables which resulted in worsening forward-looking...

...the capital adequacy ratio (Full IFRS 9 Impact) closed at 23.85% (vs. 22.51% in the third quarter of 2019).

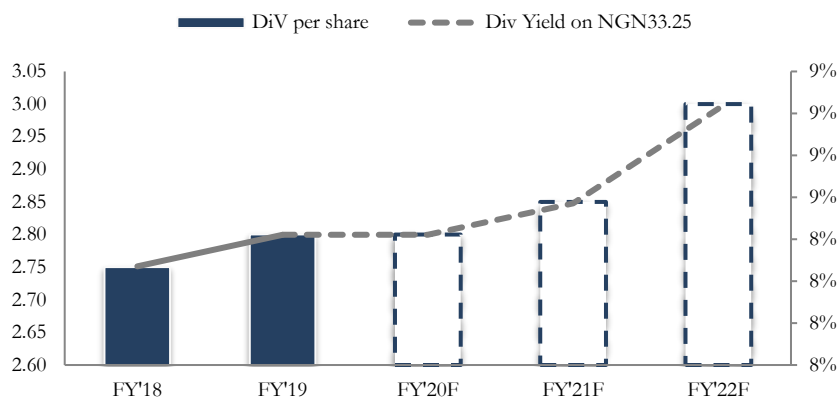
Also, the liquidity ratio closed at 38.78% in Q3'20 (vs. 49.33% in Q3'19). With the robust balance sheet, the bank may likely reward the shareholders with final dividend of ₦2.50 in FY'20, having paid the interim dividend of ₦0.30 in H1'20.

Fig. 10: Total Liabilities Vs Net Asset in 9M'20



Source: Guaranty Trust Bank Plc, PAC Research

Fig. 11: Dividend Per Share and Dividend Yield (FY'18 - FY'22F)



Source: Guaranty Trust Bank Plc, PAC Research

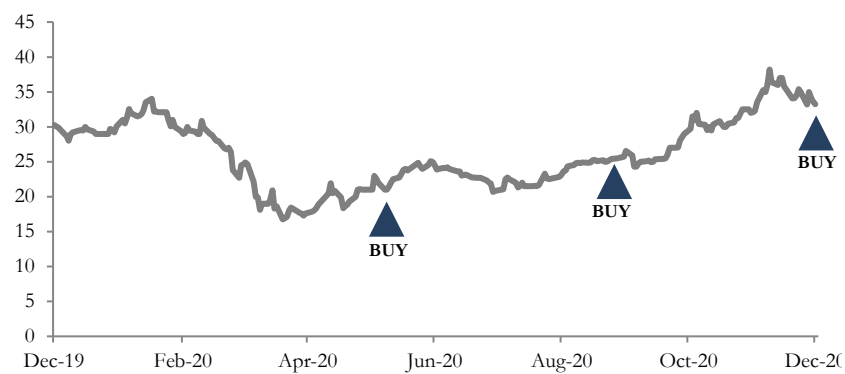
Valuation

Our valuation puts the target price of the stock at ₦36.94, representing an increase of 11.10% from the current price of ₦33.25. In arriving at the target price, we employed Residual Income Model and Dividend Discount 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 bank, the current figures released by the bank, the performance of the bank in the banking industry and the outlook of Management of the banks.

Our valuation puts the target price of the stock at N36.94, representing an increase of 11.10% from the current price of N33.25

Fig. 12: Share Price History (Naira)



Source: NSE, PAC Research

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

	2018	2019	2020E	2021F
Gross Earnings	434,699	435,307	441,836	457,300
Change		0.14%	1.50%	3.50%
Interest and Similar Income	306,963	296,205	304,867	320,110
Change		-3.50%	2.92%	5.00%
Interest and Similar Expenses	-84,530	-64,842	-51,253	-54,870
Change		-23.29%	-20.96%	7.07%
Net Interest Income	222,434	231,363	253,614	265,230
Change		4.01%	9.62%	4.58%
Impairment Charge for credit losses	-4,906	-4,912	-14,139	-16,000
Change		0.11%	187.86%	13.20%
Net Fees and Commission Income	50,470	59,444	42,637	47,100
Change		17.78%	-28.27%	10.47%
Trade gains	24,584	20,890	26,510	27,430
Change		-15.03%	26.90%	3.50%
Personnel expenses	-36,856	-37,284	-37,998	-39,320
Change		1.16%	1.91%	3.50%
Profit Before Taxation	215,587	231,708	227,987	243,510
Change		7.48%	-1.61%	6.81%
Taxation	-30,947	-34,842	-34,198	-36,520
Change		12.59%	-1.85%	6.81%
Profit After Taxation	184,640	196,866	193,789	206,990
Change		6.62%	-1.56%	6.81%

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

	2018	2019	2020E	2021F
Cash and cash equivalents	676,989	593,551	593,551	596,479
Loans and advances	1,262,005	1,502,085	1,592,112	1,647,836
Financial assets held for trading -Available for Sale/fair value thru other compr. Income	11,315	73,486	243,010	251,515
Held to Maturity	98,620	145,561	176,734	182,920
Assets pledged as collateral	56,777	58,037	61,857	64,022
Loans and advances to banks	2,995	1,513	1,502	1,555
Loans and adv. to customers	1,259,010	1,500,572	1,590,610	1,646,281
Property and equipment	111,826	141,775	154,643	160,055
Restr. deposits & other assets	508,679	577,433	1,170,866	1,211,846
Total Assets	3,287,343	3,758,919	4,642,107	4,805,130
Deposits from banks	82,803	107,518	97,204	100,606
Deposits from customers	2,273,903	2,532,540	3,247,496	3,361,158
Other liabilities	140,448	233,426	508,112	525,895
Deferred tax liabilities	7,786	10,569	11,046	11,433
Debt securities issued	0	0	0	0
Other borrowed funds	178,567	163,000	141,388	137,190
Total Liabilities	2,711,775	3,071,581	4,031,932	4,165,458
Net Assets	575,567	687,337	610,176	639,672
Total equity and liabilities	3,287,343	3,758,919	4,642,107	4,805,130

Fig. 15: Profitability Ratio

	2018	2019	2020E	2021F
Return on Equity	32.08%	28.64%	31.76%	32.36%
Return on Assets	5.62%	5.24%	4.17%	4.31%
Net interest income to Revenue	51.17%	53.15%	57.40%	58.00%
PBT margin	49.59%	53.23%	51.60%	53.25%
Net Profit Margin	42.48%	45.22%	43.86%	45.26%
ROCE	10.09%	9.72%	6.66%	6.91%

Fig. 16: Asset Utilisation

	2018	2019	2020F	2021F
Cash/Revenue	155.74%	136.35%	135.00%	135.00%
Revenue to total assets (x)	13.22%	11.58%	9.52%	9.52%
Interest Income / Total Assets	9.34%	7.88%	6.57%	6.66%
Loan Loss Exp./Net Int. Income	2.21%	2.12%	5.57%	6.03%
Loan Loss Exp./After Tax Profit	2.66%	2.49%	7.30%	7.73%
fixed asset turnover	0.50%	0.52%	0.55%	0.57%

Fig. 17: Liquidity Ratios

	2018	2019	2020E	2021F
Current ratio	1.21	1.22	1.15	1.15
Cash ratio	0.25	0.19	0.15	0.15
Interest Coverage ratio	2.55	3.57	4.45	4.44
Liquid Assets/Total Deposit	24.10	20.03	23.15	23.15
Loans & Advances/Total Deposit	6.51	5.75	6.14	6.14
Liquid Assets/Total Assets	0.61	0.57	0.48	0.48
Debt/net income	0.97	0.83	0.73	0.66
Debt to asset	0.05	0.04	0.03	0.03
Debt to equity	0.31	0.24	0.23	0.21
Total Liabilities / Total Asset	0.82	0.82	0.87	0.87
Cost to income ratio net interest margin AVERAGED	0.26	0.27	0.32	0.32
Total liabilities/equities	4.71	4.47	6.61	6.51

Fig. 18: Shareholders' Investment Ratios

	2018	2019	2020E	2021F
Earnings per share	6.27	6.69	6.58	7.03
DiV per share	2.75	2.80	2.80	2.85
NAVPS	19.56	23.35	20.73	21.73
Earnings yield	20.12%	20.12%	19.80%	21.15%

Fig. 19: Capital Adequacy Ratios

	2018	2019	2020E	2021F
Loans and Advances/Equity	2.19	2.19	2.61	2.58
Equity/Total Assets	0.18	0.18	0.13	0.13
Loan Loss Expense/ Equity	0.009	0.007	0.023	0.025

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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