Guaranty Trust Bank Plc

PAC Holdings | A PROPRIETARY INVESTMENT COMPANY |

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Impressive Performance as Non-Interest Income Drives Earnings

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Price:	
- Current	**₦36.40**
- Target	**₦48.23**
Recommendation:	**STRONG BUY**

** As at Tuesday October 23, 2018*

INVESTMENT SUMMARY

The recently released unaudited nine-month to September 2018 result of Guaranty Trust Bank shows impressive performance in its top-line as gross earnings rose by 8.83% to ₦337.27 billion in CQ3'18, from ₦309.91 billion reported in CQ3'17. The improvement in top-line was boosted mainly by non-interest income as it increased by 61.78% to ₦99.73 billion in CQ3'18 (vs. ₦61.64 billion recorded in CQ3'17). Fee and commission income, forex trading gain, mark to market gains on trading investments, forex revaluation gain, dividend income and recoveries are the key drivers of significant improvement in non-interest income. Interest income remains a major challenge as it reduced by 4.32% to ₦237.55 billion in CQ3'18 (vs. ₦248.27 billion in CQ3'17), due to declining interest rates and dip in loan volume which translated to a decline of 6.66% in interest income from loans and advances. Interest expense increased by 13.97% to ₦66.90 billion in CQ3'18 (vs. ₦58.70 billion recorded in CQ3'17) while non-interest expenses rose by 13.33% to ₦104.33 billion in CQ3'18 (vs. ₦92.06 billion recorded in CQ3'17). The bank made a lower provision for loan impairment charge as it reduced by 79.22% to ₦1.74 billion in CQ3'18 (vs. ₦8.36 billion in CQ3'17).

Profit before tax rose by 9.47% to ₦164.25 billion in CQ3'18, from ₦150.03 billion in CQ3'17 while the bank made a lower tax provision of ₦22.02 billion in CQ3'18 billion (vs. ₦24.45 billion in CQ3'17). Consequently, profit after tax improved by 13.26% to ₦142.22 billion in CQ3'18, from ₦125.58 billion in CQ3'17. Impressively, 12-month trailing EPS increased by 32.92% to ₦6.36, from ₦4.78 recorded in the previous period. Based on the recent figure released by the company, we upgrade our earnings forecast and our target price. As a result, we reiterate **BUY** on the company shares at the current price of ₦36.40 as present forward estimate places the company share price at ₦48.23.

Fig. 1: Quarterly results highlights

	3Q2018	2Q2018	3Q2017	Q/q Δ	Y/y Δ
Net Int. Income (₦'mn)	52,712	58,241	60,029	-9.49%	-12.19%
PBT (₦'mn)	54,613	57,008	48,932	-4.20%	+11.61%
Net profit (₦'mn)	46,642	50,912	41,898	-8.39%	+11.32%

Source: NSE, PAC Research

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-10.67%/-4.25%
52-week range	₦31.95 - ₦57.00
30-day Average vol.	23,694,810
Shares Outstanding ('mn)	29,431.18
Market Cap. (₦bn)	1,071.29
EPS (₦) - 12months trailing	6.36
DPS (₦) - FY2017	2.70

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	CQ3'18	CQ3'17
Net Interest Margin	9.20%	10.50%
Net profit margin	42.17%	40.52%
Equity multiplier	6.43x	5.52x
Cash/ total Assets	24.10%	18.74%

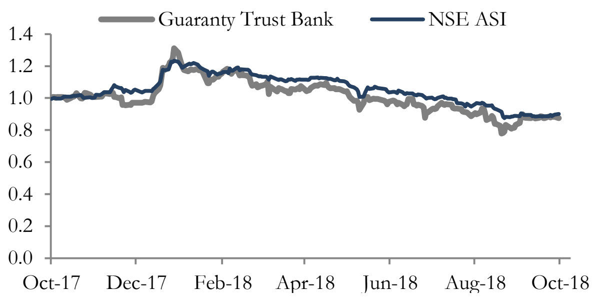
Source: NSE, PAC Research

Fig. 4: Valuation

	FY2017	FY2018E	FY2019E	FY2020E
P/E	6.28x	5.76x	4.99x	4.71x
P/B	1.71x	1.56x	1.49x	1.39x
Div Yield (%)	7.42	7.55	7.83	8.24
Payout Ratio	46.61%	43.50%	39.09%	38.84%
Ev/Revenue	1.82%	1.63%	1.40%	1.24%
Rev per share	14.24	15.20	16.35	17.61
ROE	27.27%	27.03%	29.91%	29.55%
ROA	5.09%	5.25%	5.52%	5.44%

Source: NSE, PAC Research

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



Source: Bloomberg, PAC Research

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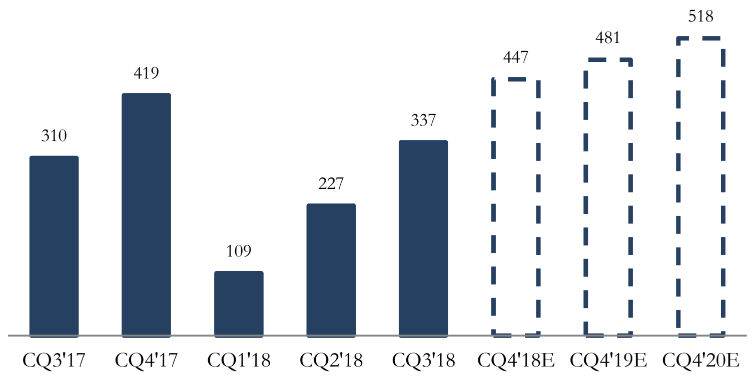
Gross earnings improves by 8.83% YoY, triggers by non-interest income

The bank reported an impressive performance in its top-line as gross earnings increased by 8.83% to ₦337.27billion in CQ3’18 (vs. ₦309.91 billion achieved in CQ3’17). The improvement in the gross earnings came as a result of significant growth in non-interest income, which overshadows the moderate drop recorded in interest income line. In the period under review, non-interest income increased by 61.78% to ₦99.73 billion in CQ3’18 (vs. ₦61.64 billion recorded in CQ3’17). The increase in non-interest income was strengthened by fee and commission income, foreign exchange trading gain, mark to market gains on trading investments, foreign exchange revaluation gain, gain on disposal of fixed assets, and dividend income and recoveries. As a result of declining interest rates and dip in loan volume which translated to a decline of 6.66% in interest income from loans and advances, the interest income dropped by 4.32% to ₦237.55 billion in CQ3’18 (vs. ₦248.27 billion in CQ3’17)

The improvement in the gross earnings came as a result of significant growth in non-interest income, which overshadows the moderate drop recorded in interest income line.

Fig. 6: Grosss Earnings – Cummulative Quarters CQ3’17-CQ4’20E (Billion NGN)



Source: NSE, PAC Research

Interest income declines due to lower interest rates and dip in loan volume

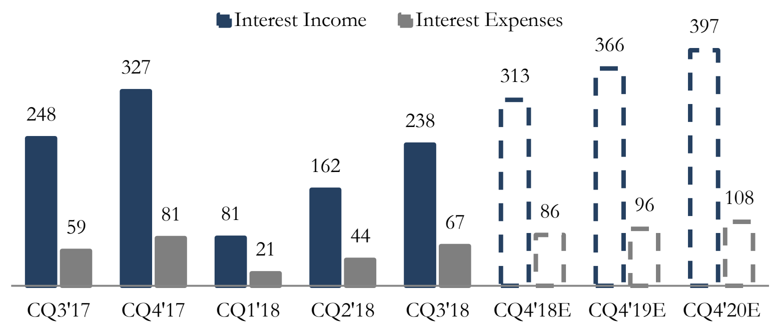
Due to declining interest rates and dip in loan volume during the period under review, interest income dropped by 4.32% to ₦237.55 billion in CQ3’18 (vs. ₦248.27 billion in CQ3’17). The bank continues to monitor its loans and advances during the period. Loans and advances reduced by 11.06% to ₦1.27 trillion in CQ3’18, from ₦1.43 trillion reported in CQ3’17. Consequently, interest income from total loans and advances declined by 6.66% to ₦143.57 billion in CQ3’18, from ₦153.81 billion reported in CQ3’17.

Due to increase of 18.49% in bank’s total deposits in the CQ3’18, total interest expenses increased by 13.97% to ₦66.90 billion in CQ3’18 (vs. ₦58.70 billion reported in CQ3’17).

The bank continues to monitor its loans and advances during the period. Loans and advances reduced by 11.06% to ₦1.27 trillion in CQ3’18, from ₦1.43 trillion reported in CQ3’17.

Interest expenses on deposit from customers (which accounts for 80.61% of the total interest expenses) increased by 22.19% to ₦53.93 billion in CQ3'18 (vs. ₦44.14 billion in CQ3'17). Therefore, net interest income dropped by 9.98% to ₦170.64 billion in CQ3'18 (vs. ₦189.57 billion in CQ3'17)

Fig. 7: Interest Income and Interest Expenses: CQ3'17-CQ4'20E (Billion NGN)



Source: NSE, PAC Research

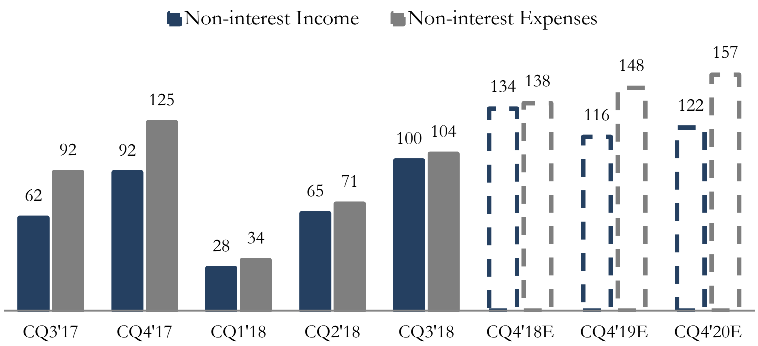
Impressive performance from non-interest income with moderate non-interest expenses

During the period under review, the bank recorded a significant improvement in the non-interest income as it increased by 61.78% to ₦99.73 billion in CQ3'18 (vs. ₦61.64 billion published in CQ3'17). The improvement in non-interest income can be attributed to significant improvement in fee and commission income, net gains on financial instruments classified as held for trading, mark to market gains on trading investments, foreign exchange revaluation gain and dividend income and recoveries. Fees and commission income rose by 19.47% to ₦40.35 billion in CQ3'18 (vs. ₦33.77 billion reported in CQ3'17), due to improvement in account maintenance charges, corporate finance fees, E-business income, commission on forex deals, among others. Net gains on financial instruments held for trading rose by 101.89% to ₦20.07 billion in CQ3'18 (vs. ₦9.94 billion recorded in CQ3'17) as the bank continues to judiciously utilised Naira and Foreign Currency (FCY) liquidity in taking appropriate positions in fixed income and FX market. In addition, the bank recorded another impressive performance in foreign exchange revaluation gain and dividend income and recoveries as they increased by 120.12% and 3,300.05% to ₦25.69 billion and ₦6.10 billion respectively in CQ3'18. However, non-interest expenses increased by 13.33% to ₦104.33 billion in CQ3'18 (vs. ₦92.06 billion reported in CQ3'17) and this is credited to increase in personal expenses and other operating expenses. Personnel expenses increased by 14.18% to ₦28.12 billion in CQ3'18 (vs. ₦24.63 billion in CQ3'17) while other operating expenses increased by 11.16% to ₦58.94 billion in CQ3'18, from ₦53.02 billion reported in CQ3'17.

The improvement in the non-interest income can be attributed to significant improvement in fee and commission income, net gains on financial instruments classified as held for trading, mark to market gains on trading investments…

Operating lease expenses increased by 57.99% to ₦2.29 billion in CQ3'18 (vs. ₦1.45 billion in CQ3'17).

Fig. 8: Non-Int. Income and Non-Int. Expense: CQ3'17-CQ4'20E (Billion NGN)



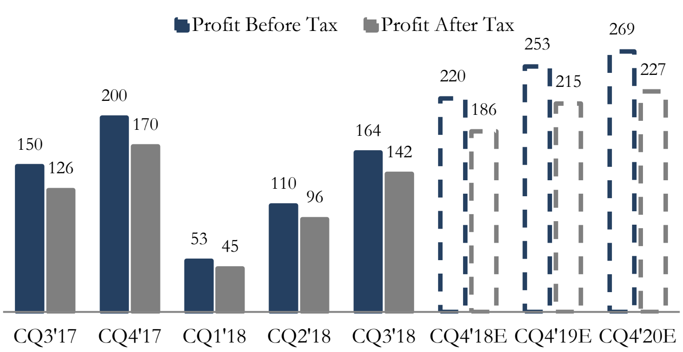
Source: NSE, PAC Research

With improvement in non-interest income and lower provision for loan impairment charges, profit before tax grows by 9.47%

In addition to the benefit derived from non-interest income during the period, the bank benefited from lower provision made for impairment charges on credit losses as it declined by 79.22% to ₦1.74 billion (vs. ₦8.36 billion in CQ3'17). The reduction in loan impairment charges came as a result of recovery of loan amount previously written off. With significant improvement in non-interest income, substantial reduction in loan impairment charges and moderate increase in costs of fund, profit before tax increased by 9.47% to ₦164.25 billion in CQ3'18 (vs. ₦150.03 billion in CQ3'17). Provision of ₦22.02 billion was made for tax in CQ3'18 (vs. ₦24.45 billion in CQ3'17) and as a result, profit after tax rose by 13.26% to ₦142.22 billion in CQ3'18 (vs. ₦125.58 billion reported in CQ3'17). The impressive performance in the bottom-line reflected on the 12-month trailing earnings per share as it increased by 32.92% to ₦6.36 from ₦4.78 recorded in the corresponding period of previous year.

With significant improvement in non-interest income, substantial reduction in loan impairment charges and moderate increase in costs of fund, profit before tax increased by 9.47% to ₦164.25 billion…

Fig. 9: Profit before Tax and Profit after Tax – CQ3'17-CQ4'20E (Billion NGN)



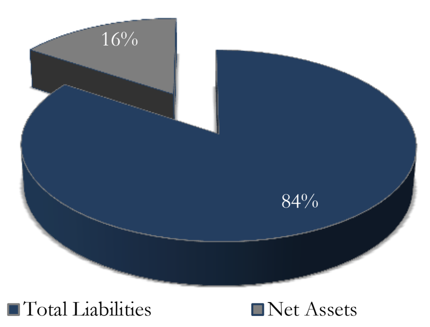
Source: NSE, PAC Research

Balance sheet remain strong and liquid; improved final dividend is guaranteed

The balance sheet of the bank remain strong and liquid as total assets increased by 6.86% to ₦3.43 trillion in Q3'18 (vs. ₦3.21 trillion in Q3'17). Total liabilities increased by 10.18% to ₦2.90 trillion in Q3'18, from ₦2.63 trillion recorded in Q3'17. As a result, net assets declined by 8.18% to ₦534.30 billion in Q3'18 (vs. ₦581.91 billion reported in Q3'17). To avoid high non-performing loans experienced in the banking sector in the recent years, the bank continues to monitor its loans and advances as it declined by 11.06% to ₦1.27 trillion in CQ3'18 (vs. ₦1.43 trillion recorded in CQ3'17). Consequently, non-performing loan to total loan ratio declined to 5.57% in Q3'18. Liquidity and capital adequacy ratio of the bank are well above industry requirements of 30% and 15% respectively. Liquidity ratio is 43.86% while capital adequacy ratio of the bank remains at 22.03% in Q3'18. In addition to interim dividend per share of ₦0.30 paid in H1'18, we expect an improved final dividend of ₦2.45 in FY'18 as we have upgraded the bank's profit after tax forecast for FY'18 to ₦186.04 billion.

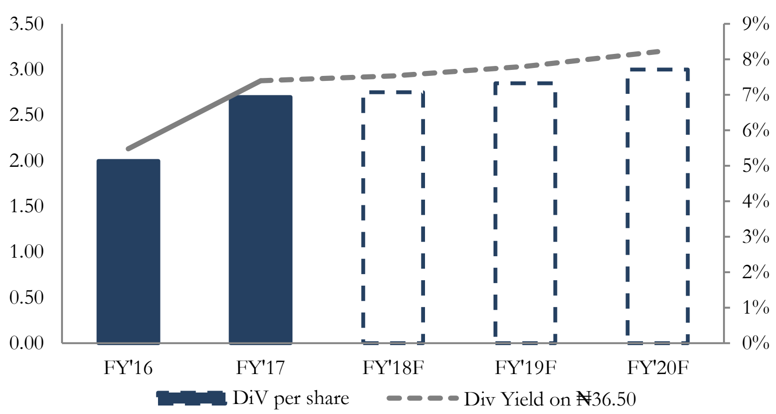
To avoid high non-performing loans experienced in the banking sector in the recent years, the bank continues to monitor its loans and advances as it declined by 11.06% to ₦1.27 trillion in CQ3'18

Fig. 10: Total Liabilities Vs Net Asset in CQ3'18



Source: NSE, PAC Research

Fig. 11: Dividend Per Share and Dividend Yield (FY'16-FY'20F)



Source: NSE, PAC Research

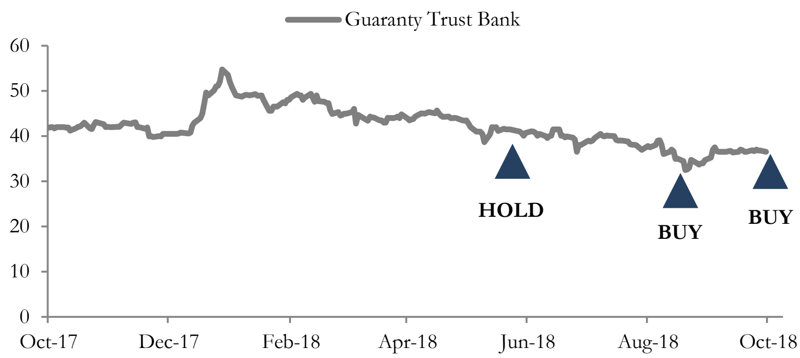
Valuation

Our valuation puts the target price of the stock at ₦48.23, representing an increase of 32.50% from the current price of ₦36.40. In arriving at the target price, we employed Residual Income Model. Consequently, we upgrade to 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 N48.23, representing an increase of 32.50% from the current price of N36.40.

Fig. 12: Share Price History



Source: NSE, PAC Research

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

	2016	2017	2018E	2019E
Gross Earnings	414,616	419,226	447,314	481,310
Change		1.11%	6.70%	7.60%
Interest and Similar Income	262,494	327,334	313,120	365,796
Change		24.70%	-4.34%	16.82%
Interest and Similar Expenses	-67,094	-80,670	-85,884	-96,262
Change		20.23%	6.46%	12.08%
Net Interest Income	195,400	246,663	227,236	269,534
Change		26.23%	-7.88%	18.61%
Impairment Charge for credit losses	-65,290	-12,169	-2,908	-4,813
Change		-81.36%	-76.11%	65.54%
Net Fees and Commission Income	35,947	40,732	49,562	55,303
Change		13.31%	21.68%	11.58%
Trade gains	5,218	11,339	27,733	29,841
Change		117.28%	144.59%	7.60%
Personnel expenses	-29,453	-32,832	-37,127	-39,467
Change		11.47%	13.08%	6.30%
Profit Before Taxation	165,136	200,242	220,168	253,073
Change		21.26%	9.95%	14.95%
Taxation	-32,856	-29,772	-34,126	-38,492
Change		-9.38%	14.62%	12.79%
Profit After Taxation	132,281	170,470	186,042	214,581
Change		28.87%	9.14%	15.34%

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

	2016	2017	2018E	2019E
Cash and cash equivalents	455,863	641,974	697,811	779,723
Loans and advances	1,590,084	1,449,284	1,462,718	1,573,885
Financial assets held for trading	12,054	23,946	29,970	32,729
-Available for Sale/fair value tru other compr. Income	448,057	517,493	559,143	625,703
Held to Maturity	80,156	96,467	125,248	158,832
Assets pledged as collateral	48,216	58,976	68,931	65,940
Loans and advances to banks	654	750	895	1,059
Loans and adv. to customers	1,589,430	1,448,533	1,461,824	1,572,826
Property and equipment	93,488	98,670	103,061	110,894
Restr. deposits & other assets	371,996	444,947	472,588	516,879
Total Assets	3,116,393	3,351,097	3,542,238	3,888,987
Deposits from banks	125,068	85,431	113,036	115,514
Deposits from customers	1,986,246	2,062,048	2,191,841	2,382,486
Other liabilities	115,682	218,349	170,919	264,721
Deferred tax labilities	17,641	18,076	19,145	20,600
Debt securities issued	126,238	92,132	98,320	105,792
Other borrowed funds	219,634	220,492	236,093	254,036
Total Liabilities	2,611,491	2,725,929	2,854,000	3,171,594
Net Assets	504,903	625,168	688,238	717,393
Total equity and liabilities	3,116,393	3,351,097	3,542,238	3,888,987

Fig. 15: Profitability Ratio

	2016	2017	2018E	2019E
Return on Equity	26.20%	27.27%	27.03%	29.91%
Return on Assets	4.24%	5.09%	5.25%	5.52%
Net interest income to Revenue	47.13%	58.84%	50.80%	56.00%
PBT margin	39.83%	47.76%	49.22%	52.58%
Net Profit Margin	31.90%	40.66%	41.59%	44.58%
ROCE	7.84%	9.53%	10.17%	10.31%

Fig. 16: Asset Utilisation

	2016	2017	2018E	2019E
Cash/Revenue	109.95%	153.13%	156.00%	162.00%
Revenue to total assets (x)	13.30%	12.51%	12.63%	12.38%
Interest Income / Total Assets	8.42%	9.77%	8.84%	9.41%
Loan Loss Exp./Net Int. Income	33.41%	4.93%	1.28%	1.79%
Loan Loss Exp./After Tax Profit	49.36%	7.14%	1.56%	2.24%
fixed asset turnover	22.55%	23.54%	0.62%	0.65%

Fig. 17: Liquidity Ratios

	2016	2017	2018E	2019E
Current ratio	1.19	1.23	1.24	1.23
Cash ratio	0.17	0.24	0.24	0.25
Interest Coverage ratio	2.46	2.48	2.56	2.63
Liquid Assets/Total Deposit	16.74	25.17	19.72	20.95
Loans &Advances/Total Deposit	3.58	6.06	4.95	5.42
Liquid Assets/Total Assets	0.67	0.64	0.63	0.62
Debt/net income	1.66	1.29	1.27	1.18
Debt to asset	0.07	0.07	0.07	0.07
Debt to equity	0.44	0.35	0.34	0.35
Total Liabilities / Total Asset	0.84	0.81	0.81	0.82
Cost to income ratio	0.48	0.24	0.27	0.24
net interest margin AVERAGED	0.08	0.08	0.08	0.08
Total liabilities/equities	5.17	4.36	4.15	4.42

Fig. 18: Shareholders' Investment Ratios

	2016	2017	2018E	2019E
Earnings per share	4.49	5.79	6.32	7.29
DiV per share	2.00	2.70	2.75	2.85
NAVPS	17.16	21.24	23.38	24.38
Earnings yield	12.35%	15.91%	17.37%	20.03%

Fig. 19: Capital Adequacy Ratios

	2016	2017	2018E	2019E
Loans and Advances/Equity	3.15	2.32	2.13	2.19
Equity/Total Assets	0.16	0.19	0.19	0.18
Loan Loss Expense/ Equity	0.13	0.02	0.00	0.01

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

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