

# Guaranty Trust Bank Plc

Nigeria | Equities | Financial Services | March 14, 2019

PAC RESEARCH

## Non-interest Income and Lower Impairment Charges Buoy Profitability

### INVESTMENT SUMMARY

The recently released FY'18 audited report by Guaranty Trust Bank showed an impressive figure in the top-line as gross earnings increased by 3.69% to ₦434.70 billion (vs. ₦419.23 billion in FY'17). The improvement in top-line was enhanced mainly by non-interest income, which increased by 39.00% to ₦127.74 billion in FY'18 (vs. ₦91.89 billion reported in FY'17). However, the bank suffered a setback in its core operation as interest income declined by 6.22% to ₦306.96 billion in FY'18 (vs. ₦327.33 billion in FY'17). Interest expense rose by 4.78% to ₦84.53 billion (vs. ₦80.67 billion in FY'17) while operating expenses increased by 1.04% to ₦127.13 billion in FY'18 (vs. ₦125.82 billion in FY'17). Impressively, a lower provision of ₦4.91 billion was made for loan impairment charge in FY'18 (vs. ₦12.17 billion in FY'17).

With impressive non-interest income and lower impairment charge, profit before tax rose by 9.06% to ₦215.59 billion in FY'18 (vs. ₦197.69 billion in FY'17). The bank made a lower tax provision of ₦30.95 billion in FY'18 (vs. ₦29.77 billion in FY'17). Consequently, profit after tax improved by 9.96% to ₦184.64 billion (vs. ₦167.91 billion in FY'17). This is in line with our projection as PAT figure is 0.75% higher than our forecast of ₦186.04 billion for FY'18F. Impressively, 12-month trailing EPS increased by 10.10% to ₦6.54, from ₦5.94 recorded in the previous period. In line with our projection, the bank proposed a final dividend of ₦2.45 per share (2017 Final dividend: ₦2.40) after the payment of ₦0.30 as interim dividend per share in 2018 (2017 interim dividend: ₦0.25), totalling ₦2.75 in FY'18 (FY'17: ₦2.70). Based on the recent figure released by the company, we upgrade our target price and as a result, we reiterate **BUY** on the company shares at the current price of ₦35.40 as present forward estimate places the company share price at ₦48.28 (Previous target price: ₦48.23).

Fig. 1: Quarterly results highlights

	4Q2018	3Q2018	4Q2017	Q/q Δ	Y/y Δ
Net Int. Income (₦mn)	51,792	52,712	57,097	-1.75%	-9.29%
PBT (₦mn)	51,341	54,613	47,652	-5.99%	+7.74%
Net profit (₦mn)	42,416	46,642	42,335	-9.06%	+0.19%

Source: NSE, PAC Research

March 14, 2019

Oluwole Adeyeye

oluwole.adeyeye@panafricancapitalholdings.com

Price:

- Current	₦35.40
- Target	₦48.28
<b>Recommendation:</b>	<b>STRONG BUY</b>

\* As at Thursday March 14, 2019

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+2.76%/-25.55%
52-week range	₦30.90 - ₦48.50
30-day Average vol.	24,773,170
Shares Outstanding ('mn)	29,431.18
Market Cap. (₦bn)	1,041.86
EPS (₦) - 12months trailing	6.54
DPS (₦) - FY2018	2.75

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	FY'18	FY'17
Net Interest Margin	9.23%	10.42%
Net profit margin	42.48%	40.05%
Equity multiplier	5.71x	5.41x
Cash/ total Assets	20.59%	19.16%

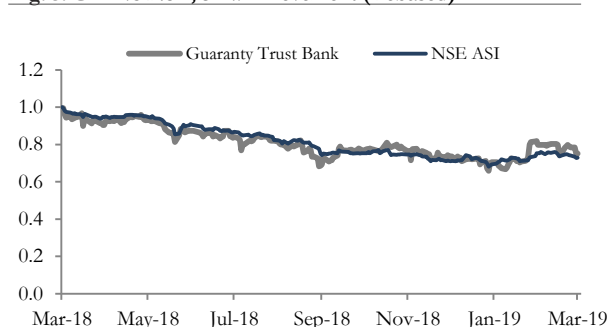
Source: NSE, PAC Research

Fig. 4: Valuation

	FY2017	FY2018	FY2019F	FY2020F
P/E	6.11x	5.64x	5.17x	4.67x
P/B	1.68x	1.81x	1.77x	1.62x
Div Yield (%)	7.63	7.77	8.05	8.47
Payout Ratio	46.61%	43.83%	41.66%	39.56%
Ev/Revenue	1.76%	1.29%	1.25%	1.09%
Rev per share	14.24	14.77	15.89	17.10
ROE	27.11%	32.08%	34.13%	34.69%
ROA	5.09%	5.62%	5.92%	6.10%

Source: NSE, PAC Research

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



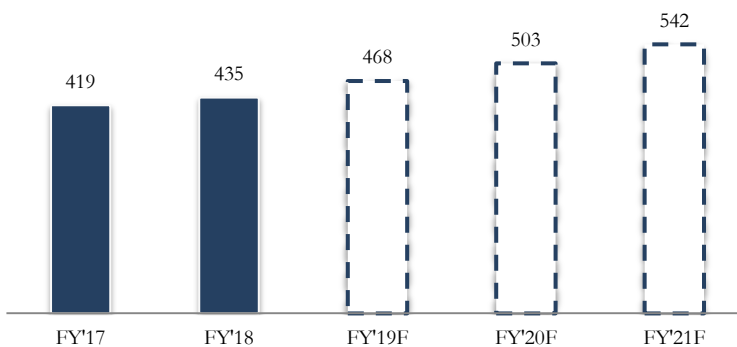
Source: Bloomberg, PAC Research

### Gross earnings grows by 3.69% YoY, boosted by non-interest income

Over the years, Guaranty Trust Bank Plc has been consistently growing the top line and 2018 is not an exemption year as gross earnings increased by 3.69% to ₦434.70 billion (vs. ₦419.23 billion reported in 2017). The figure for the top-line is 2.82% below our projection of ₦447.31 billion for gross earnings in FY'18F. However, the growth in the top line could be mainly traced to impressive improvement in non-interest income as it increased by 39.00% to ₦127.74 billion in FY'18 (vs. ₦91.89 billion recorded in FY'17). The key drivers of non-interest income are fee & commission income, forex trading gain, gain from bonds trading, mark to market gains on trading investments and forex revaluation gain. However, interest income of the bank recorded a setback as it declined by 6.22% to ₦306.96 billion in FY'18 (vs. ₦327.33 billion in FY'17). The unimpressive number of interest income is attributed mainly to declining yields on fixed income securities and contraction of loan books during the period.

*The growth in the top line could be mainly traced to impressive improvement in non-interest income as it increased by 39.00% to ₦127.74 billion in FY'18...*

Fig. 6: Gross Earnings – FY'17-FY'21F (Billion NGN)



Source: NSE, PAC Research

### With lower yields and contraction of the loan books, interest income falls by 6.22%

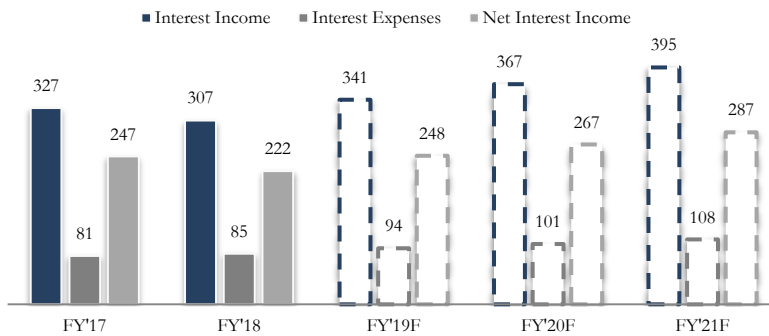
In the full year 2018, Guaranty Trust Bank Plc recorded a lower growth in interest income as it fell by 6.22% to ₦306.96 billion in FY'18 (vs. ₦327.33 billion in FY'17). The dip in interest income can be attributed to the declining yields on fixed income securities and contraction of the loan books during the period. The combined impacts of declining yields and dip in loans volume reflected on interest income from total loans and advances as it declined by 6.11% to ₦190.80 billion in FY'18 (vs. ₦203.23 billion reported in FY'17).

During the period, interest expenses increased by 4.78% to ₦84.53 billion (vs. ₦80.67 billion reported in FY'17). The intense competition for deposits among banks and other financial institutions and continued customers' appetite for treasury bills contributed to higher interest expenses as Guaranty Trust Bank Plc motivated their customers with higher interest rates.

*The combined impacts of declining yields and dip in loans volume reflected on interest income from total loans and advances as it declined by 6.11% to ₦190.80 billion in FY'18...*

This translated to higher interest expenses on deposit from customers (which accounts for 80.42% of the total interest expenses) as the figure increased by 14.14% to ₦67.98 billion in FY'18, from ₦59.56 billion in FY'17. Consequently, net interest income dropped by 9.82% to ₦222.43 billion in FY'18 (vs. ₦246.66 billion in FY'17)

Fig. 7: Int. Income, Int. Expenses and NII: FY'17-FY'21F (Billion NGN)



Source: NSE, PAC Research

#### Significant improvement in non-interest income with moderate operating expenses

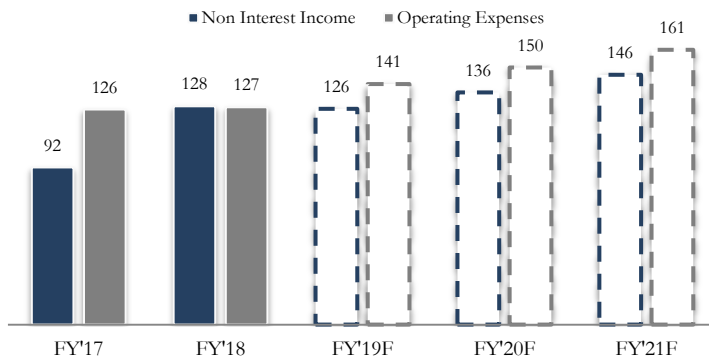
The bank recorded an impressive performance in non-interest income as it rose by 39.00% to ₦127.74 billion in full year 2018 (vs. ₦91.89 billion recorded in full year 2017). The impressive performance of the bank in the area of non-interest income can be attributed to the significant improvement in fee & commission income, forex trading gain, gain from bonds trading, mark to market gains on trading investments and forex revaluation gain. Fees and commission income rose by 22.01% to ₦54.37 billion in FY'18 (vs. ₦42.92 billion in FY'17), as a result of increased advisory services activity and transactional volumes on products and services offering via digital channels and innovative solution. Net gains on financial instruments held for trading increased by 116.81% to ₦24.58 billion in FY'18 (vs. ₦11.34 billion recorded in FY'17) as the bank judiciously utilised Naira and Foreign Currency liquidity in taking appropriate positions in fixed income and FX market. The bank also recorded impressive figures in foreign exchange revaluation gain and mark to market gains on trading investments as they increased by 21.70% and 7,929.72% to ₦31.08 billion and ₦0.62 billion respectively in FY'18.

However, the bank maintained cost efficiency as operating expenses increased marginally by 1.04% to ₦127.13 billion in FY'18 (vs. ₦125.82 billion reported in FY'17), resulted in cost to income ratio of 37.09% in FY'18 (FY'17: 38.8%).

*However, the bank maintained cost efficiency as operating expenses increased marginal by 1.04% to ₦127.13 billion in FY'18 (vs. ₦125.82 billion reported in FY'17), resulted in cost to income ratio of 37.09% in FY'18...*

The growth in OPEX was largely as a result of the interplay of 4.00% YoY growth in AMCON expenses, 12.00% growth in personal expenses principally from devaluation impact of translating the subsidiaries staff costs from their original currency to Naira, 15.00% growth in depreciation and amortisation and 36.00% increase in customer service related expenses.

Fig. 8: Non-Int. Income and Operating Expenses: FY'17-FY'21F (Billion NGN)



Source: NSE, PAC Research

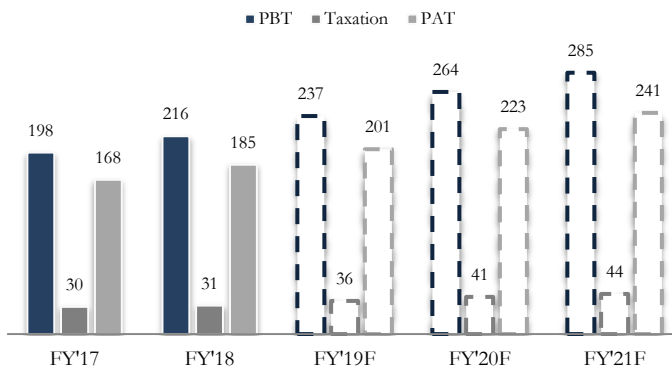
#### **PBT grows by 9.06% YoY, due to higher non-interest income, moderate OPEX growth and lower impairment charges**

Overall, Guaranty Trust Bank delivered a good financial performance across all the key profitability metrics in full year 2018 as the bank maintained its historical profitability growth. Profit before tax increased by 9.06% to ₦184.64 billion in full year 2018, from ₦197.69 billion recorded in full year 2017. Despite the declining yield environment and other regulatory cap on fees and commission in 2018, PBT margin increased by 244 bps to 49.59% (2017: 47.15%). The growth in profit before tax is mainly driven by efficient balance sheet management, growth in transactional volumes, strong asset quality, cost efficiency and lower impairment charges. The bank made a lower provision of ₦4.91 billion for loan impairment charges in full year 2018 (vs. ₦12.17 billion in 2017).

However, the bank made a provision of ₦30.95 billion for tax in FY'18 (vs. ₦29.77 billion in FY'17). This represents a lower tax margin of 14.35% in full year 2018, when compared to the tax margin of 15.06% in full year 2017. Consequently, profit after tax increased by 9.96% to ₦184.64 billion in FY'18 (vs. ₦167.92 billion in FY'17) and this is 0.76% below our forecast of ₦186.04 billion for FY'18F. The impressive performance of the bank showed on the 12-month trailing earnings per share as it increased by 10.10% to ₦6.54, from ₦5.94 achieved in the corresponding period of previous year.

*The growth in profit before tax is mainly driven by efficient balance sheet management, growth in transactional volumes, strong asset quality, cost efficiency and lower impairment charges*

Fig. 9: Profit before Tax and Profit after Tax – FY'17-FY'21F (Billion NGN)



Source: NSE, PAC Research

### With Efficient and well structured balance sheet, the bank records improved total dividend of ₦2.75 per share

In year 2017, Guaranty Trust Bank maintained a strong and solid balance sheet in full year of 2018. The strong liquidity position of the bank is backed by robust capital buffers with capital adequacy ratio of 23.4% in 2018 (2107: 25.68%), which is well above the regulatory requirement of 16.00%. Also, the liquidity ratio of the bank is strong at 41.44% in full year 2018 (vs. 47.56% in full year 2017) as it is above the regulatory requirement of 30.00%. The bank continue to monitor its loans portfolio and this can be seen in loan-to-deposit ratio as it declined to 53.55% in 2018 (2017: 67.49%). Impressively, non-performing loan ratio declined to 7.30% in 2018 (2017: 7.66%). Information, Telecoms & Transport industry is the major contributor to total non-performing loan (57.00%), followed by General Commerce (25%). However, upstream oil & gas sector and manufacturing industry have the highest share of the loans given out in 2018 as they contributed 24.00% and 19.00% respectively to loans by sector.

During the period, the total assets of the bank declined by 1.90% to ₦3.29 trillion (vs. ₦3.35 trillion in FY'18) while total liabilities declined by 0.73% to ₦2.71 trillion in FY'18 (vs. ₦2.73 trillion in FY'17). Consequently, net asset fell by 7.08% to ₦575.57 billion in FY'18 (vs. ₦619.40 billion in FY'17) while net asset per share diminished to ₦19.56 in 2018, from ₦21.05 reported in 2017. In line with our projection, the bank proposed a final dividend of ₦2.45 per share (2017 Final dividend: ₦2.40) after the payment of ₦0.30 as interim dividend per share in 2018 (2017 interim dividend: ₦0.25), totalling ₦2.75 in FY'18 (FY'17: ₦2.70).

*The strong liquidity position of the bank is backed by robust capital buffers with capital adequacy ratio of 23.4% in 2018 (2107: 25.68%), which is well above the regulatory requirement...*

Fig. 10: Total Liabilities Vs Net Asset in FY18

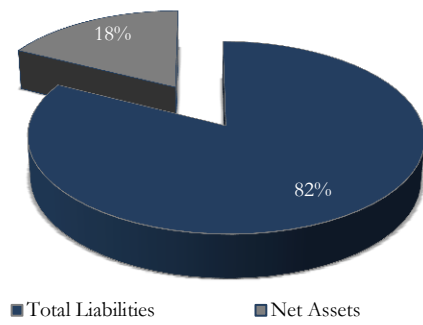


Fig. 11: Dividend Per Share and Dividend Yield (FY'17-FY'21F)

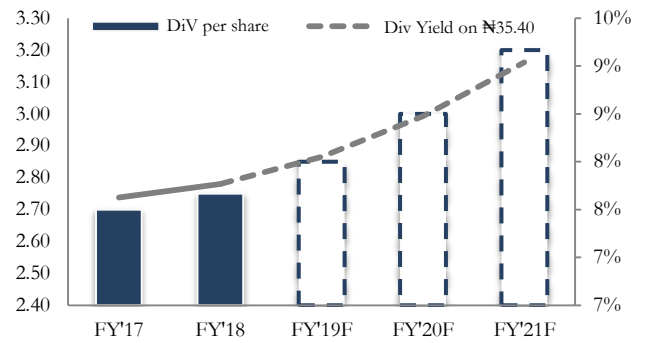


Fig. 12: Loans by Sector – FY'18

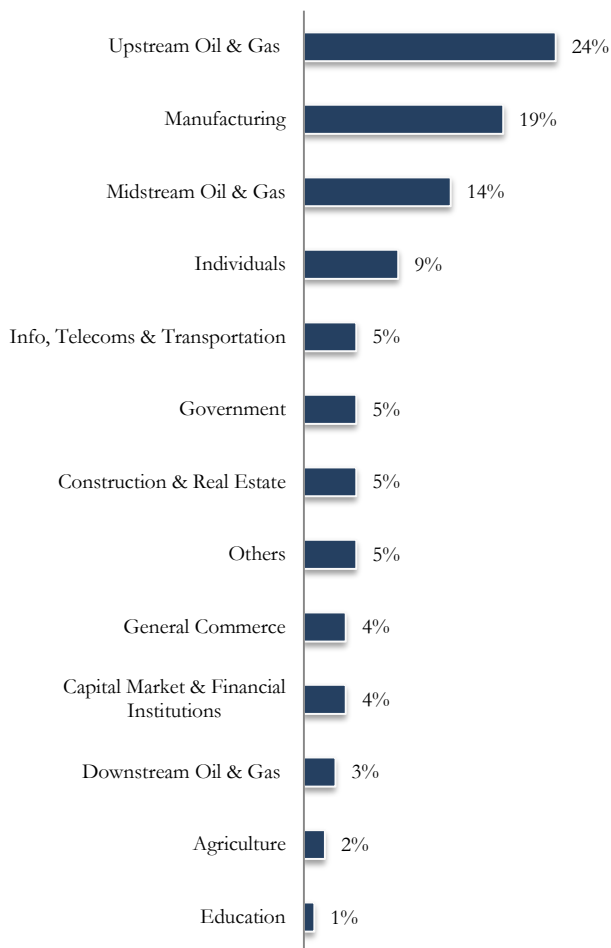
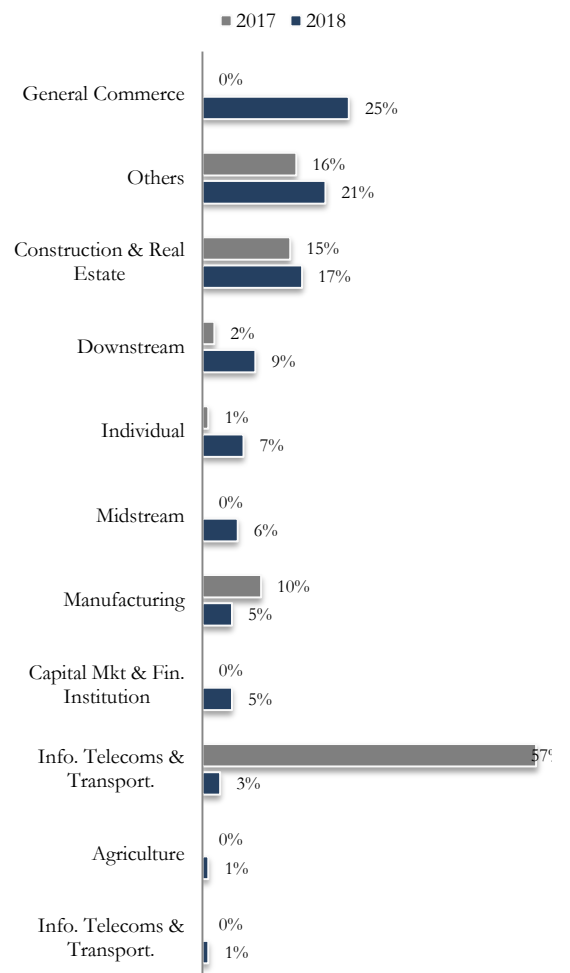


Fig. 13: NPL by Sector – FY'18



Source: NSE, PAC Research

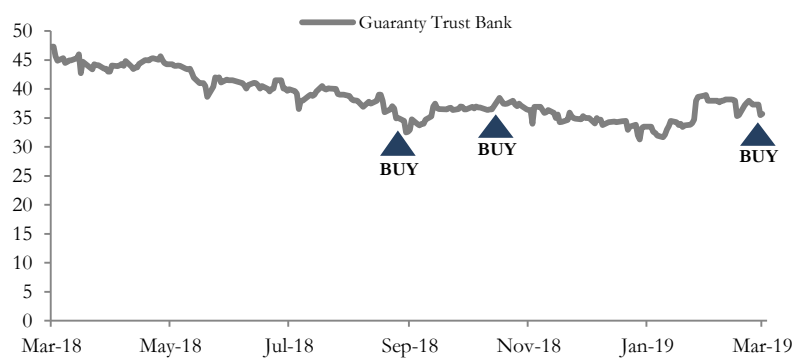
### Valuation

Our valuation puts the target price of the stock at ₦48.28, representing an increase of 36.39% from the current price of ₦35.40. 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 ₦48.28, representing an increase of 36.39% from the current price of ₦35.40*

**Fig. 14: Share Price History (Naira)**



Source: NSE, PAC Research

**Fig. 14: Statement of Profit or Loss, N'mn**

	2017	2018	2019F	2020F
Gross Earnings	419,226	434,699	467,736	503,284
Change		3.69%	7.60%	7.60%
Interest and Similar Income	327,334	306,963	341,447	367,397
Change		-6.22%	11.23%	7.60%
Interest and Similar Expenses	-80,670	-84,530	-93,547	-100,657
Change		4.78%	10.67%	7.60%
Net Interest Income	246,663	222,434	247,900	266,741
Change		-9.82%	11.45%	7.60%
Impairment Charge for credit losses	-12,169	-4,906	-4,677	4,530
Change		-59.68%	-4.67%	-196.84%
Net Fees and Commission Income	40,732	50,470	58,420	63,162
Change		23.91%	15.75%	8.12%
Trade gains	11,339	24,584	29,000	30,197
Change		116.81%	17.96%	4.13%
Personnel expenses	-32,832	-36,856	-38,822	-41,773
Change		12.26%	5.33%	7.60%
Profit Before Taxation	197,685	215,587	237,470	263,721
Change		9.06%	10.15%	11.05%
Taxation	-29,772	-30,947	-36,119	-40,508
Change		3.95%	16.71%	12.15%
Profit After Taxation	167,913	184,640	201,350	223,213
Change		9.96%	9.05%	10.86%

**Fig. 16: Statement of Fin. Position, N'mn**

	2017	2018	2019F	2020F
Cash and cash equivalents	641,974	676,989	729,668	785,123
Loans and advances	1,449,284	1,262,005	1,242,775	1,337,226
Financial assets held for trading -Available for Sale/fair value tru other compr. Income	23,946	11,315	16,371	17,615
Held to Maturity	96,467	98,620	116,934	125,821
Assets pledged as collateral	58,976	56,777	62,677	67,440
Loans and advances to banks	750	2,995	3,274	3,523
Loans and adv. to customers	1,448,533	1,259,010	1,239,501	1,333,703
Property and equipment	98,670	111,826	112,257	120,788
Restr. deposits & other assets	444,947	508,679	509,832	548,580
Total Assets	3,351,097	3,287,343	3,398,898	3,658,120
Deposits from banks	85,431	82,803	81,854	85,558
Deposits from customers	2,062,048	2,273,903	2,291,907	2,466,092
Other liabilities	224,117	140,448	144,998	150,985
Deferred tax liabilities	18,076	7,786	20,019	21,541
Debt securities issued	92,132	0	56,128	60,394
Other borrowed funds	220,492	178,567	187,094	201,314
Total Liabilities	2,731,696	2,711,775	2,808,896	3,014,722
Net Assets	619,400	575,567	590,002	643,398
Total equity and liabilities	3,351,097	3,287,343	3,398,898	3,658,120

**Fig. 17: Profitability Ratio**

	2017	2018	2019F	2020F
Return on Equity	27.11%	32.08%	34.13%	34.69%
Return on Assets	5.09%	5.62%	5.92%	6.10%
Net interest income to Revenue	58.84%	51.17%	53.00%	53.00%
PBT margin	47.15%	49.59%	50.77%	52.40%
Net Profit Margin	40.05%	42.48%	43.05%	44.35%
ROCE	9.36%	10.09%	10.70%	11.12%

**Fig. 18: Asset Utilisation**

	2017	2018	2019F	2020F
Cash/Revenue	153.13%	155.74%	156.00%	156.00%
Revenue to total assets (x)	12.51%	13.22%	13.76%	13.76%
Interest Income / Total Assets	9.77%	9.34%	10.05%	10.04%
Loan Loss Exp./Net Int. Income	4.93%	2.21%	1.89%	1.70%
Loan Loss Exp./After Tax Profit	7.25%	2.66%	2.32%	2.03%
fixed asset turnover	23.54%	0.50%	0.65%	0.65%

**Fig. 19: Liquidity Ratios**

	2017	2018	2019F	2020F
Current ratio	1.23	1.21	1.21	1.21
Cash ratio	0.24	0.25	0.26	0.26
Interest Coverage ratio	2.45	2.55	2.54	2.62
Liquid Assets/Total Deposit	25.17	24.10	24.86	25.59
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	0.93	0.90
Debt to asset	0.07	0.05	0.06	0.06
Debt to equity	0.36	0.31	0.32	0.31
Total Liabilities / Total Asset	0.82	0.82	0.83	0.82
Cost to income ratio net interest margin AVERAGED	0.25	0.26	0.25	0.24
Total liabilities/equities	4.41	4.71	4.76	4.69

**Fig. 20: Shareholders' Investment Ratios**

	2017	2018	2019F	2020F
Earnings per share	5.79	6.27	6.84	7.58
DiV per share	2.70	2.75	2.85	3.00
NAVPS	21.05	19.56	20.05	21.86
Earnings yield	16.22%	17.57%	19.16%	21.24%

**Fig. 21: Capital Adequacy Ratios**

	2017	2018	2019F	2020F
Loans and Advances/Equity	2.34	2.19	2.11	2.08
Equity/Total Assets	0.18	0.18	0.17	0.18
Loan Loss Expense/ Equity	0.02	0.01	0.01	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

**IMPORTANT DISCLOSURES**

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**PanAfrican Capital Holdings Ltd**

8A, Elsie Femi Pearse Street

Victoria Island

Lagos, Nigeria

Tel: +234 (1) 2716899, 2718630

[www.panafricancapitalholdings.com](http://www.panafricancapitalholdings.com)