Guaranty Trust Bank Plc

PAC Holdings RC254413
| A PROPRIETARY INVESTMENT COMPANY |

Nigeria | Equities | Financial Services | March 13, 2020 — PAC RESEARCH

GTB Benefits from Non-interest Income Lines as Profit After Tax Hits ₦197 Billion

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Price:	
- Current	**₦18.10**
- Target	**₦33.32**
Recommendation:	**STRONG BUY**

** As at Thursday March 12, 2020*

INVESTMENT SUMMARY

The recently released full year 2019 audited report by Guaranty Trust Bank showed an impressive figure in the top-line as gross earnings rose marginally by 0.14% to ₦435.31 billion (vs. ₦434.70 billion in full year 2018). The improvement in top-line was enhanced mainly by non-interest income, which increased by 8.90% to ₦139.10 billion in FY'19 (vs. ₦127.74 billion reported in FY'18). However, the bank suffered a setback in its core operation as interest income declined by 3.50% to ₦296.21 billion in FY'19 (vs. ₦306.96 billion in FY'18), due to lower yield during the period. Impressively, the bank benefited from lower yield in 2019 as interest expense fell by 23.29% to ₦64.84 billion (vs. ₦84.53 billion in 2018). However, operating expenses rose by 3.02% to ₦130.97 billion in (vs. ₦127.13 billion in FY'18) while loan impairment charge was stable at ₦4.91 billion in FY'19 (vs. ₦4.91 billion in FY'18).

With impressive non-interest income and moderate OPEX growth, profit before tax rose by 7.48% to ₦231.71 billion in FY'19 (vs. ₦215.59 billion in FY'18). The bank made a higher tax provision of ₦34.84 billion in FY'19 billion (vs. ₦30.88 billion in FY'18). Consequently, profit after tax improved by 6.58% to ₦196.87 billion (vs. ₦184.71 billion in FY'18). Impressively, EPS increased by 6.42% to ₦6.96 in 2019, from ₦6.54 recorded in 2018. In line with our projection, the bank proposed a final dividend of ₦2.50 per share (2018 final dividend: ₦2.45) after the payment of ₦0.30 as interim dividend per share in 2019 (2018 interim dividend: ₦0.30), totalling ₦2.80 in FY'19 (FY'18: ₦2.75). Based on the recent figure released by the company, the impact of COVID-19 on the global economy and exposure of GTB to the oil sector, we downgrade our target price to ₦33.32 (Previous target price: ₦45.17) and as a result, we reiterate **BUY** on the company shares at the current price of ₦18.10

Fig. 1: Quarterly results highlights

	4Q2019	3Q2019	4Q2018	Q/q Δ	Y/y Δ
Net Int. Income (₦'mn)	58,426	56,572	51,792	+3.28%	+12.81%
PBT (₦'mn)	61,056	54,864	51,341	+11.29%	+18.92%
Net profit (₦'mn)	49,876	47,856	42,416	+4.22%	+17.59%

Source: NSE, PAC Research

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-39.06%/-51.47%
52-week range	₦18.00 - ₦37.70
30-day Average vol.	54,558,090
Shares Outstanding ('mn)	29,431.18
Market Cap. (₦bn)	532.70
EPS (₦) - 12months trailing	6.96
DPS (₦) - FY2019	2.80

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	FY'19	FY'18
Net Interest Margin	9.28%	9.23%
Net profit margin	45.22%	42.49%
Equity multiplier	5.47x	5.70x
Cash/ total Assets	15.79%	20.59%

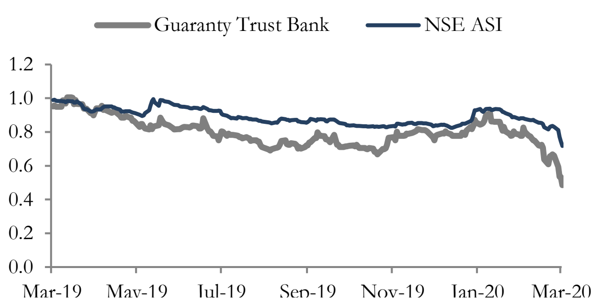
Source: NSE, PAC Research

Fig. 4: Valuation

	FY2018	FY2019	FY2020F	FY2021F
P/E	2.89x	2.71x	2.68x	2.64x
P/B	0.93x	0.78x	0.75x	0.75x
Div Yield (%)	15.19	15.47	15.47	15.75
Payout Ratio	43.83%	41.86%	41.47%	41.55%
Ev/Revenue	0.10	0.26%	0.18%	0.14%
Rev per share	14.77	14.79	14.49	14.93
ROE	32.08%	28.64%	28.16%	28.24%
ROA	5.62%	5.24%	5.18%	5.10%

Source: NSE, PAC Research

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



Source: Bloomberg, PAC Research

Please read the Important Disclosures at the end of this report.

Gross earnings grows by 0.14% YoY, boosts by non-interest income: Guaranty Trust Bank Plc has been consistently growing the top line over the years and 2019 is not exempted as gross earnings increased by 0.14% to ₦435.31 billion (vs. ₦434.70 billion reported in 2018). The figure for the top-line is 2.71% higher than our projection of ₦423.83 billion for gross earnings in FY'19F. However, the growth in the top line can be mainly traced to impressive improvement in non-interest income as it increased by 8.90% to ₦139.10 billion in FY'19 (vs. ₦127.74 billion recorded in FY'18). The key drivers of non-interest income are fee & commission income, gain from bonds trading, discounts & recoverables (FX), among others. On the other hand, interest income of the bank recorded a setback as it declined by 3.50% to ₦296.21 billion in FY'19 (vs. ₦306.96 billion in FY'18). The unimpressive figure for total interest income can be mainly attributed to declining yields environment in 2019. However, the 8.90% growth recorded on non-interest income was strong enough to offset the 3.50% decline in interest income.

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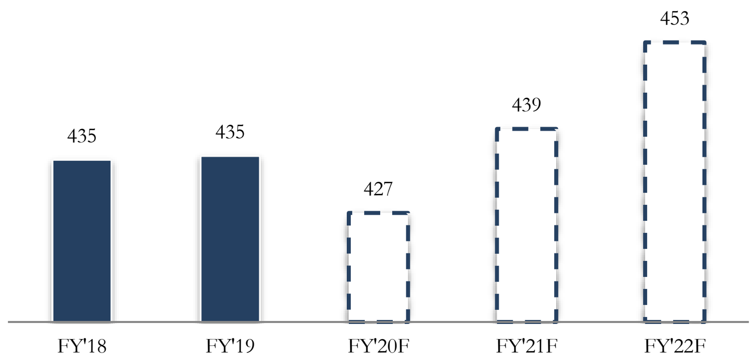
Fig. 6: Grosss Earnings – FY'18 - FY'22F (Billion NGN)



Source: NSE, PAC Research

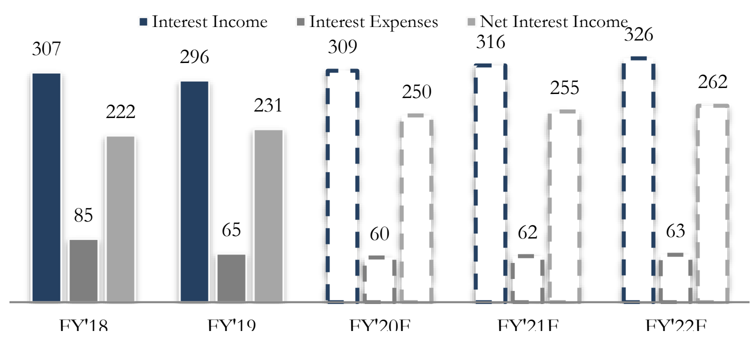
With lower yields environment in 2019, interest income falls by 3.50%: In line with our projection, the interest income of Guaranty Trust Bank Plc fell by 3.50% to ₦296.21 billion in FY'19 (vs. ₦306.96 billion in FY'18). The dip in interest income resulted from declining yield environment in 2019 as earning yield fell by 41 bps to 11.92% in FY'19 (FY'18: 12.33%). The decline in earning asset yield can be attributed to lower portfolio yield on treasury bills and lower yield on local currency (LCY) loans portfolio during the period. Portfolio yield on T-bills fell by 40bps to 15.20% (2018: 15.60%), while yields on LCY loan portfolio fell by 70bps to 15.80% in 2019 (2018: 16.50%). In addition, there was a reduction in average volume of earnings assets during the period as it fell by 3.50% to ₦2.04 trillion (vs. ₦2.12 trillion in 2018), resulted principally from ₦82.90 billion reduction in LCY term loan average volume due to scheduled pay-downs which weighed negatively on the new loans booked in 2019.

The decline in earning asset yield can be attributed to lower portfolio yield on treasury bills and lower yield on local currency (LCY) loans portfolio during the period

Consequently, interest income from loans and advances to customers fell by 5.05% to ₦178.42 billion in 2019 (vs. ₦187.90 billion in 2018), while interest income on investment securities fell by 1.25% to ₦90.21 billion in 2019 (vs. ₦91.34 billion in 2018). Going forward, we expect to see an increase in interest income lines due to the higher loan-to-deposit ratio of 65.00% required by the Central Bank of Nigeria. Currently the bank's loan-to-deposit ratio of 60.62% is below the new regulatory requirement of 65.00%.

During the period, interest expenses fell significantly by 23.29% to ₦64.84 billion (vs. ₦84.53 billion reported in FY'18). The decline in interest expenses during the period can be attributed to the benefits the bank derived from repricing of time deposits, sustained low cost deposit mix, cost savings impact from Eurobond redemption in November 2018 and repayment of expensive USD borrowed funds. We expect interest expenses to fall further in 2020 due to the current low interest rate in the money market and fixed income market.

Fig. 7: Int. Income, Int. Expenses and NII: FY'18 - FY'22F (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 8.90% to ₦139.10 billion in full year 2019 (vs. ₦127.74 billion recorded in full year 2018). The impressive performance of the bank in the area of non-interest income line can be attributed to the significant improvement in fee & commission income, gain from bonds trading, discounts & recoverables (FX), among others. Fees and commission income increased significantly by 19.19% to ₦62.42 billion in FY'19 (vs. ₦52.37 billion in FY'18), mainly as a result of increased transaction volumes across the bank's digital channels, high income from growth in volume of FX transactions and new loan bookings. In addition, other income increased by ₦55.79 billion in 2019 (vs. ₦50.78 billion 2018), as a result of increase in loans recoveries which rose to N15.63 billion in 2019, from N6.53 billion in 2018. Going forward, we expect to see a reduction in non-interest income of the bank due to introduction of lower bank charges by the Central Bank of Nigeria in the beginning of 2020.

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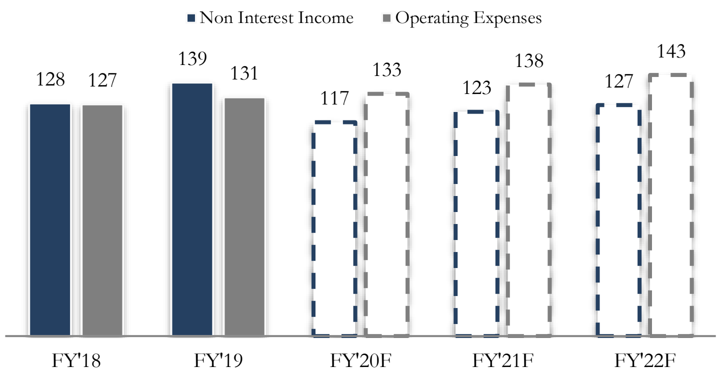
However, GTBank maintained cost efficiency as operating expenses increased by 3.02% to ₦130.97 billion in FY'19 (vs. ₦127.13 billion reported in FY'18) and this resulted in cost-to-income ratio of 36.11% in FY'19 (FY'18: 37.09%). The increase in operating expenses is far below the inflation rate of 11.98% for the month of December 2019. The growth in OPEX was largely as a result of 1.16% growth in personnel, 28.72% growth in depreciation and amortisation, 1.39% increase in operating lease expenses, among others.

Fig. 8: Non-Int. Income and Operating Expenses: FY'18 - FY'22F (Billion NGN)



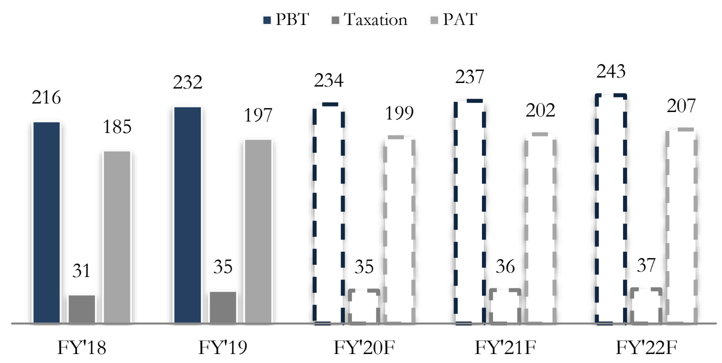
Source: NSE, PAC Research

PBT grows by 7.48%, due to higher non-interest income, moderate OPEX growth and modest loan impairment charges: In addition to the benefits derived from higher non-interest income, lower interest expenses and moderate operating expenses, the bank also benefited from moderate loan impairment charges during the period. In 2019, loan impairment charges remained flat at ₦4.91 billion, when compared with 2018. Going forward, we expect to see an increase in loan impairment charges of the bank due to the new minimum loan-to-deposit ratio of 65.00% required by the Central Bank of Nigeria. The reason for this forecast is that banks will be forced to lend money out to people in order to achieve the LDR ratio and this may trigger high non-performing loans in the Nigerian banking industry.

Going forward, we expect to see increase in loan impairment charges of the bank due to the new minimum loan-to-deposit ratio of 65.00% required by the Central Bank of Nigeria

As a result of higher non-interest income, cost efficiency and moderate OPEX growth, profit before tax increased by 7.48% to ₦231.71 billion in FY'19 (vs. ₦215.59 billion reported in FY'18). The bank made a higher provision of ₦34.84 billion for tax during the period (FY'18: ₦30.88 billion) and as a result, profit after tax increased by 6.58% to ₦196.87 billion in FY'19 (vs. ₦184.71 billion in FY'18). Impressively, the performance of the bank showed on EPS as it improved by 6.42% to ₦6.96, from ₦6.54 recorded in 2018.

Fig. 9: Profit before Tax and Profit after Tax – FY'18 - FY'22F (Billion NGN)



Source: NSE, PAC Research

With Efficient and well structured balance sheet, the bank records a total dividend of ₦2.80 per share: Guaranty Trust Bank Plc maintained a strong and solid balance sheet in full year of 2019. The strong liquidity position of the bank is backed by robust capital buffers with capital adequacy ratio of 22.51% in 2019 (2018: 23.39%), which is well above the regulatory requirement of 16.00%. Also, the liquidity ratio of the bank is strong at 49.33% in full year 2019 (vs. 41.44% in full year 2018), as it is above the regulatory requirement of 30.00%. As a result of new loan-to-deposit regulatory requirement of 65.00%, the bank increased its loan-to-deposit ratio to 60.62% in 2019 (2018: 57.01%). Despite the increase in LDR, non-performing loan ratio declined to 6.53% in 2019 (2018: 7.30%). General Commerce is the major contributor to total non-performing loan (26%) in 2019. However, upstream oil & gas sector and manufacturing industry have the highest share of the loans given out in 2019 as they contributed 28.00% and 19.00% respectively to loans by sector. In total, 45.00% of the total loans belongs to the oil sector (Upstream (28%), Midstream (13%) and Downstream oil and Gas (4%)). This is a major threat to the bank's NPL ratio due to the lower crude oil price in the market, caused by the 'price war' between Saudi Arabia and Russia. Consequently, we expect higher loan impairment charges in 2020.

In total, 45.00% of the total loans belongs to oil sector (Upstream (28%), Midstream (13%) and Downstream oil and Gas (4%)). This is a major threat to the bank's NPL ratio due to the lower crude oil prices…

During the period, the total assets of the bank declined by 14.35% to ₦3.76 trillion (vs. ₦3.29 trillion in FY'18), mainly as a result of higher loans. Due to significant improvement in total deposit, total liabilities of the bank rose by 13.30% to ₦3.07 trillion in FY'19 (vs. ₦2.71 trillion in FY'18). Consequently, net asset jumped by 19.27% to ₦687.34 billion in FY'19 (vs. ₦576.28 billion in FY'18) and this resulted in net asset per share of ₦23.35 (2018: ₦19.58). In line with our projection, the bank proposed a final dividend of ₦2.50 per share (2018 Final dividend: ₦2.45), after the payment of ₦0.30 as interim dividend per share in 2019 (2018 interim dividend: ₦0.30), totalling ₦2.80 in FY'19 (FY'18: ₦2.75).

The Annual General Meeting is scheduled for 30th March 2020. If approved at the general meeting, the final dividend will be paid on the 30th of March 2020 to shareholders, whose names appear on the Register of Members as at March 18 2020 and who have completed the e-dividend registration and mandated the registrar to pay their dividends directly into their bank account.

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

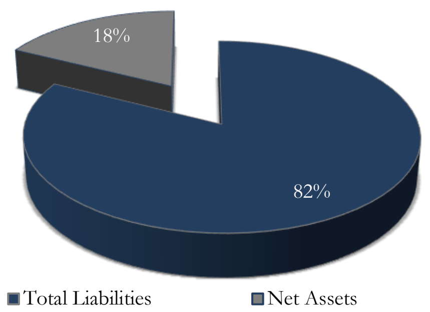


Fig. 11: Dividend Per Share and Dividend Yield (FY'18 - FY'22F)

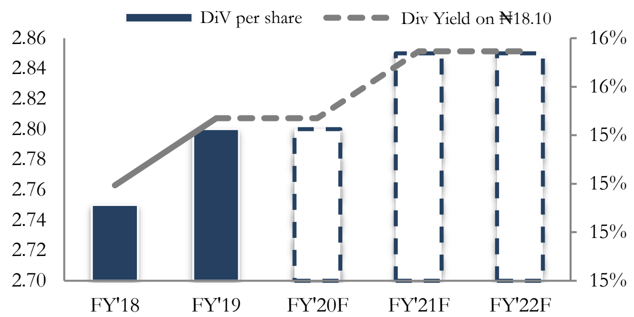


Fig. 12: Loans by Sector – FY'19

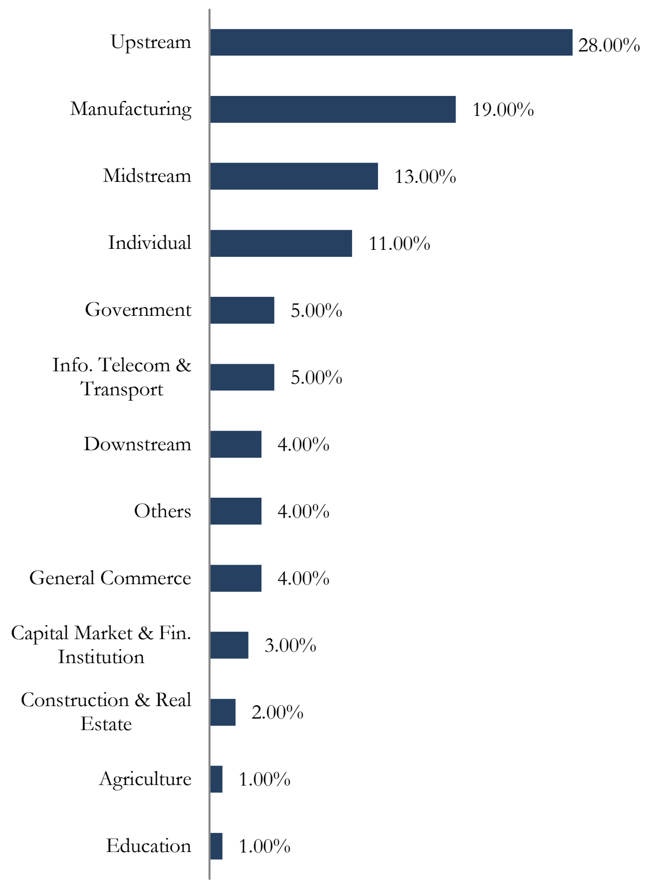
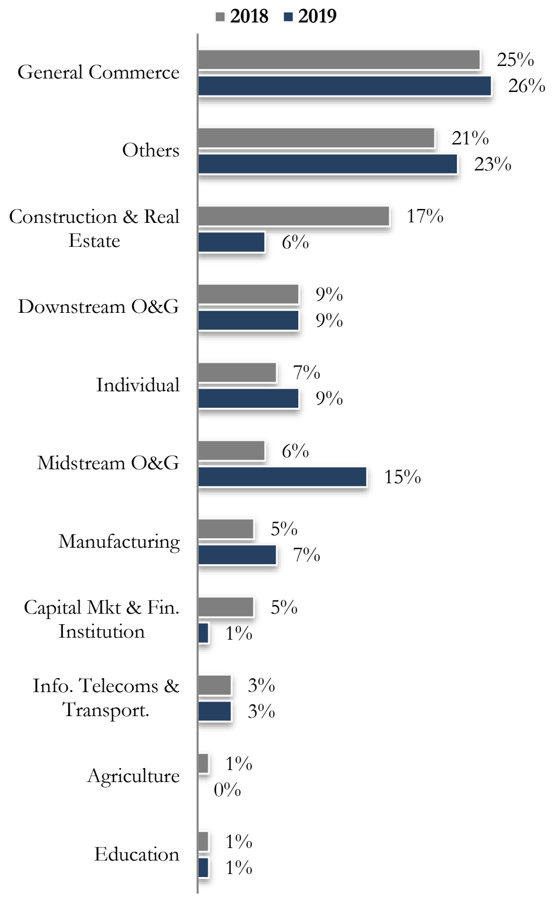


Fig. 13: NPL by Sector – FY'19



Source: Guaranty Trust Bank Plc, PAC Research

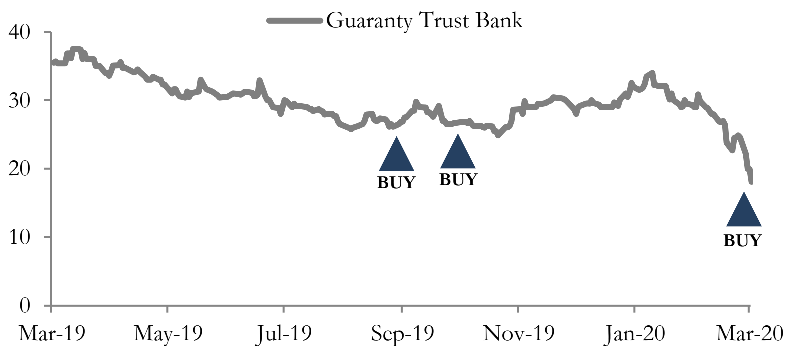
Valuation

Our valuation puts the target price of the stock at ₦33.32, representing an increase of 84.06% from the current price of ₦18.10. In arriving at the target price, we employed Residual Income Model and Dividend Discount 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 N33.32, representing an increase of 84.06% from the current price of N18.10

Fig. 14: Share Price History (Naira)



Source: NSE, PAC Research

Fig. 15: Statement of Profit or Loss, N'mn

	2018	2019	2020F	2021F
Gross Earnings	434,699	435,307	426,600	439,398
Change		0.14%	-2.00%	3.00%
Interest and Similar Income	306,963	296,205	309,285	316,367
Change		-3.50%	4.42%	2.29%
Interest and Similar Expenses	-84,530	-64,842	-59,724	-61,516
Change		-23.29%	-7.89%	3.00%
Net Interest Income	222,434	231,363	249,561	254,851
Change		4.01%	7.87%	2.12%
Impairment Charge for credit losses	-4,906	-4,912	-8,105	-8,349
Change		0.11%	65.02%	3.00%
Net Fees and Commission Income	50,470	59,444	48,206	49,652
Change		17.78%	-18.90%	3.00%
Trade gains	24,584	20,890	21,330	21,970
Change		-15.03%	2.11%	3.00%
Personnel expenses	-36,856	-37,284	-36,901	-38,228
Change		1.16%	-1.03%	3.60%
Profit Before Taxation	215,587	231,708	233,777	237,495
Change		7.48%	0.89%	1.59%
Taxation	-30,947	-34,842	-35,067	-35,624
Change		12.59%	0.64%	1.59%
Profit After Taxation	184,640	196,866	198,710	201,871
Change		6.62%	0.94%	1.59%

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

	2018	2019	2020F	2021F
Cash and cash equivalents	676,989	593,551	593,551	618,571
Loans and advances	1,262,005	1,502,085	1,558,542	1,605,298
Financial assets held for trading	11,315	73,486	72,010	74,170
-Available for Sale/fair value tru other compr. Income	538,705	618,477	607,906	626,143
Held to Maturity	98,620	145,561	142,655	146,935
Assets pledged as collateral	56,777	58,037	59,724	61,516
Loans and advances to banks	2,995	1,513	1,450	1,494
Loans and adv. to customers	1,259,010	1,500,572	1,557,091	1,603,804
Property and equipment	111,826	141,775	149,310	153,789
Restr. deposits & other assets	508,679	577,433	580,177	606,370
Total Assets	3,287,343	3,758,919	3,832,834	3,954,937
Deposits from banks	82,803	107,518	106,650	109,850
Deposits from customers	2,273,903	2,532,540	2,602,263	2,702,300
Other liabilities	140,448	233,426	228,231	235,078
Deferred tax labilities	7,786	10,569	10,665	10,985
Debt securities issued	0	0	0	0
Other borrowed funds	178,567	163,000	153,576	153,789
Total Liabilities	2,711,775	3,071,581	3,127,152	3,240,036
Net Assets	575,567	687,337	705,682	714,901
Total equity and liabilities	3,287,343	3,758,919	3,832,834	3,954,937

Fig. 17: Profitability Ratio

	2018	2019	2020F	2021F
Return on Equity	32.08%	28.64%	28.16%	28.24%
Return on Assets	5.62%	5.24%	5.18%	5.10%
Net interest income to Revenue	51.17%	53.15%	58.50%	58.00%
PBT margin	49.59%	53.23%	54.80%	54.05%
Net Profit Margin	42.48%	45.22%	46.58%	45.94%
ROCE	10.09%	9.72%	9.65%	9.41%

Fig. 18: Asset Utilisation

	2018	2019	2020F	2021F
Cash/Revenue	155.74%	136.35%	145.00%	145.00%
Revenue to total assets (x)	13.22%	11.58%	11.13%	11.11%
Interest Income / Total Assets	9.34%	7.88%	8.07%	8.00%
Loan Loss Exp./Net Int. Income	2.21%	2.12%	3.25%	3.28%
Loan Loss Exp./After Tax Profit	2.66%	2.49%	4.08%	4.14%
fixed asset turnover	0.50%	0.52%	0.55%	0.57%

Fig. 19: Liquidity Ratios

	2018	2019	2020F	2021F
Current ratio	1.21	1.22	1.23	1.22
Cash ratio	0.25	0.19	0.20	0.20
Interest Coverage ratio	2.55	3.57	3.91	3.86
Liquid Assets/Total Deposit	24.10	20.03	20.97	20.97
Loans &Advances/Total Deposit	6.51	5.75	5.70	5.70
Liquid Assets/Total Assets	0.61	0.57	0.58	0.58
Debt/net income	0.97	0.83	0.77	0.76
Debt to asset	0.05	0.04	0.04	0.04
Debt to equity	0.31	0.24	0.22	0.22
Total Liabilities / Total Asset	0.82	0.82	0.82	0.82
Cost to income ratio	0.26	0.27	0.28	0.29
net interest margin AVERAGED	0.09	0.09	0.90	0.90
Total liabilities/equities	4.71	4.47	4.43	4.53

Fig. 20: Shareholders' Investment Ratios

	2018	2019	2020F	2021F
Earnings per share	6.27	6.69	6.75	6.86
DiV per share	2.75	2.80	2.80	2.85
NAVPS	19.56	23.35	23.98	24.29
Earnings yield	36.96%	36.96%	37.30%	37.90%

Fig. 21: Capital Adequacy Ratios

	2018	2019	2020F	2021F
Loans and Advances/Equity	2.19	2.19	2.21	2.25
Equity/Total Assets	0.18	0.18	0.18	0.18
Loan Loss Expense/ Equity	0.009	0.007	0.011	0.012

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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