

Zenith Bank Shows Resilience as Non-Interest Income Boosts Earnings

INVESTMENT SUMMARY

Against the backdrop of a challenging macro-economic environment occasioned by COVID-19, Zenith Bank recorded resilient performance in nine-month to September 2020 as gross earnings increased by 3.60% to ₦508.98 billion (vs. ₦491.27 billion in nine-month to September 2019). The increase in the gross earnings of the bank could be mainly attributed to the improvement in the non-interest income lines during the period. Due to higher foreign currency revaluation gain and treasury bills trading income, non-interest income rose by 10.67% to ₦173.49 billion in 9M'20 (vs. ₦156.76 billion in 9M'19). However, the total interest income of the bank fell marginally by 0.97% to ₦318.82 billion in 9M'20 (vs. ₦321.94 billion in 9M'19), mainly as a result of lower interest income from treasury bills. Impressively, the bank continued to benefited from the lower interest rates (which reflected on cost of funds of 2.2% in 9M'20 (9M'19: 3.0%)) as interest & similar expense fell by 12.74% to ₦93.64 billion (vs. ₦107.31 billion in 9M'19). In line with our expectation, the bank's loan impairment charge increased significantly by 37.51% to ₦25.11 billion in 9M'20 (vs. ₦18.26 billion in 9M'19) and this could be attributed to higher loan-to-deposit of 65%.

With the impressive non-interest income and lower interest & similar expenses, profit before tax improved slightly by 0.62% to ₦177.28 billion in 9M'20 (vs. ₦176.18 billion in 9M'19). The bank made a lower provision of ₦17.97 billion for income tax in 9M'20 (vs. ₦25.46 billion in 9M'19) and as a result, profit after tax increased by 5.70% to ₦159.32 billion in 9M'20 (vs. ₦150.72 billion in 9M'19). Impressively, 12-month trailing EPS rose to ₦6.93, from ₦6.37 recorded in the previous period. Based on the recently released figures, we maintain a **BUY** rating on the stock at the current price of ₦23.40 as present forward estimate places the company share price at ₦28.12 (Previous target price: ₦27.05).

Fig. 1: Quarterly results highlights

	3Q2020	2Q2020	3Q2019	Q/q Δ	Y/y Δ
Gross Earnings (₦mn)	162,887	179,274	159,681	-9.14%	+2.01%
Net Int. Income (₦mn)	67,770	75,908	72,112	-10.72%	-6.02%
Net profit (₦mn)	55,489	53,300	61,839	+4.11%	-10.27%

Source: NSE, Bloomberg, PAC Research

Oluwale Adeyeye

oluwale.adeyeye@panafricancapitalholdings.com

Price:

- Current	₦23.40
- Target	₦28.12
Recommendation:	BUY

* As at Tuesday December. 8, 2020

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+25.81%/+25.81%
52-week range	₦28.50 - ₦10.70
30-day Average vol.	52,148,130
Shares Outstanding (mn)	31,396.49
Market Cap. (₦bn)	734.68
EPS (₦) - 12 Months Trailing	6.93
DPS (₦) - FY2019	2.80

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	9M'20	9M'19
Net Interest Margin	8.30%	8.70%
Net profit margin	31.30%	30.68%
Equity multiplier	7.71	6.86
Cash/ total Assets	22.56%	15.29%

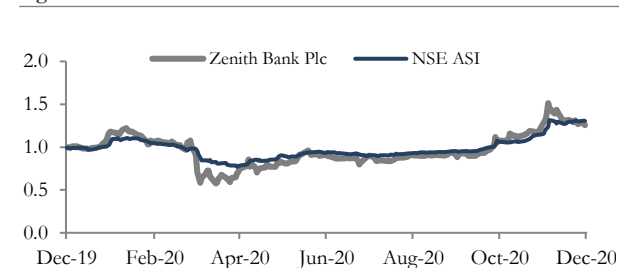
Source: NSE, Bloomberg, PAC Research

Fig. 4: Valuations

	FY2018	FY2019	FY2020E	FY2021F
P/E (x)	3.80	3.52	3.48	3.40
P/B (x)	0.90	0.78	0.69	0.67
Div Yield	11.97%	11.97%	12.18%	12.39%
Payout Ratio	45.45%	42.09%	42.35%	42.12%
EV/Revenue	1.91	1.38	0.96	0.92
Rev per share	20.08	21.09	21.73	22.49
ROE	23.71%	22.17%	29.88%	19.61%
ROA	3.25%	3.29%	2.54%	2.51%

Source: NSE, Bloomberg, PAC Research

Fig. 5: 52-Week Price Movement of ZENITH vs NSE ASI



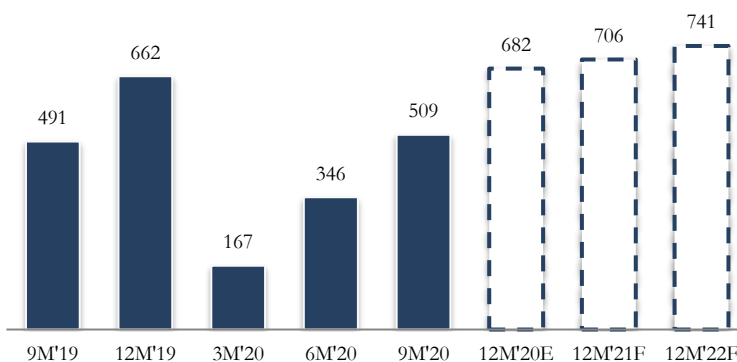
Source: Bloomberg, PAC Research

Gross earnings improves by 3.60% year-on-year, driven by non-interest

income: Despite the challenging environment occasioned by COVID-19 in this year, Zenith Bank continued to report improved top-line as gross earnings improved by 3.60% to ₦508.78 billion in nine-month to September 2020 (vs ₦491.27 billion in nine-month to September 2019). The increase in the gross earnings of the bank during this period was mainly driven by improved performance from the non-interest income lines. The bank's non-interest income increased by 10.67% to ₦173.49 billion in 9M'20 (vs. ₦156.76 billion in 9M'19), driven by higher foreign currency revaluation gain and improved treasury bills trading income. However, interest income line of the bank declined marginally by 0.97% to ₦318.82 billion in 9M'20 (vs. ₦321.94 billion in 9M'19). The slight decline in total interest income of the bank was mainly ascribed to the significant fall in interest income from treasury bills due to the lower yield in money market during the period. However, all other variables under the interest income lines recorded positive growth during the period under review.

The increase in the gross earnings of the bank during this period was mainly driven by improved performance from the non-interest income lines

Fig. 6: Gross Earnings – 9M'19 –12M'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Total interest income falls slightly by 0.97% year-on-year, mainly as a

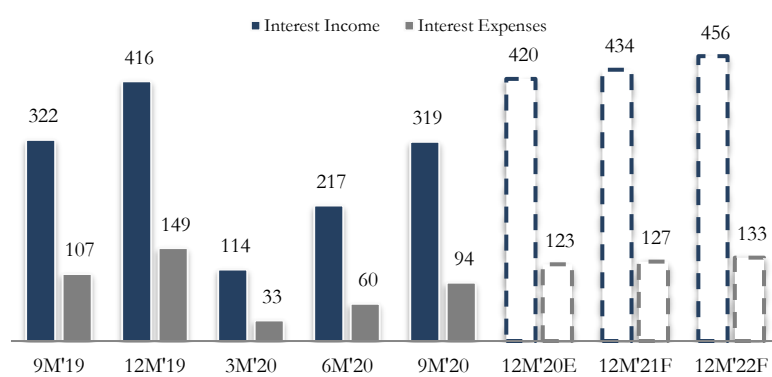
result of lower interest income from treasury bills: In line with our forecast, Zenith bank continued to benefit from the higher regulatory loan-to-deposit ratio of 65% as interest income from loans and advances to customers improved, even with reduced interest rates during the period. The improved loans to the customers outweighed the reduced interest rates on borrowings as interest income from loans and advances increased by 8.11% to ₦189.39 billion in 9M'20 (vs. ₦175.18 billion in 9M'19). In addition, interest income from government & other bonds increased by 23.03% to ₦60.64 billion in 9M'20 (vs. ₦49.29 billion in 9M'19) as the bank continue to enjoy long term position taken in the bond market when rates were high. Also, interest income from placement with banks and discount houses improved by 15.97% to ₦22.27 billion in 9M'20 (vs. ₦19.21 billion in 9M'19).

The improved loans to the customers outweighed the reduced interest rates on borrowings as interest income from loans and advances increased by 8.11%...

However, the bank's interest income from treasury bills fell significantly by 45.62% to ₦40.39 billion in 9M'20 (vs. ₦74.27 billion in 9M'19) due to the lower yield in the money market during the period. The setback in interest income from treasury bills outweighed the improvement in interest income from loans & advances to customers, government & other bonds and placement with banks and discount houses. Consequently, total interest income fell by 0.97% to ₦318.82 billion in 9M'20 (vs. ₦321.94 billion in 9M'19).

However, Zenith Bank benefited from the lower yield environment in the nine-month to September 2020 as cost of funds fell by 80 bps to 2.2% (9M19: 3.0%). As a result, the interest & similar expenses of the bank fell by 12.74% to ₦93.64 billion in 9M'20 (vs. ₦107.31 billion reported in 9M'19). Specifically, the reduction in interest and similar expenses could be mainly attributed to significant fall in interest expenses on borrowed funds as it fell by 32.22% to ₦33.31 in 9M'20 (vs. ₦49.15 billion in 9M'19). However, the interest expenses on saving accounts and time deposits rose by 2.91% and 5.26% respectively, as a result of higher deposits from the customers during the period.

Fig. 7: Interest Income and Interest Expenses: 9M'19-12M'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research,

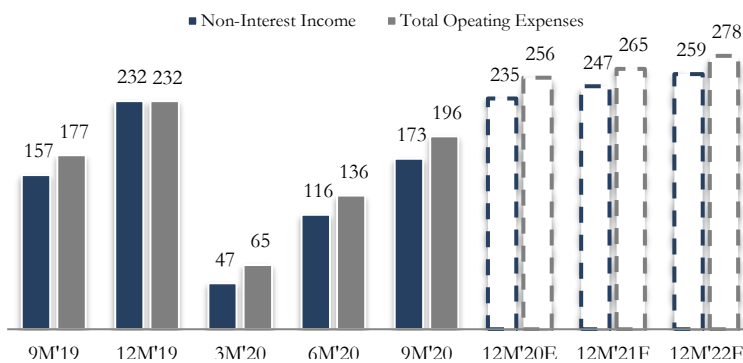
Trading income and foreign currency revaluation gain offsets the lower income from fee and commission as non-interest income improves by 10.67%: The regulatory cut to bank charges continued to bite hard into income on fee and commission as it declined significantly by 12.30% to ₦75.79 billion in nine-month to September 2020 (vs. ₦86.42 billion in nine-month to September 2019). However, trading income increased significantly by 34.34% to ₦89.82 billion in 9M'20 (vs. ₦66.86 billion in 9M'19), due to lower derivative loss, improved treasury bill trading income and higher bond trading income. Also, as a result of drop in the value of Naira in the FX market, foreign currency revaluation gain increased significantly by 52.70% to ₦20.57 billion in 9M'20 (vs. ₦13.47 billion in 9M'19).

However, the improvement in trading income and foreign currency revaluation gain offset the setback in fee and commission income.

...as a result of drop in the value of Naira in the FX market, foreign currency revaluation gain increased significantly by 52.70% to ₦20.57 billion in 9M'20...

Consequently, total non-interest income rose by 10.67% to ₦173.49 billion in 9M'20 (vs. ₦156.76 billion in 9M'19). However, the total operating expenses of the bank increased by 10.67% to ₦196.28 billion in 9M'20 (vs. ₦176.94 billion in 9M'19), due to higher depreciation of property and equipment, higher personnel expenses, higher expenses on insurance premium, information technology, advertisement, fuel and maintenance, among others. Impressively, the 10.93% increase in total operating expenses in nine-month to September 2020 is 330 bps lower than the inflation rate of 13.71% for the month of September 2020.

Fig. 8: Non-Int. Income & Total Op. Expense: 6M'19-12M'22F (Billion NGN)



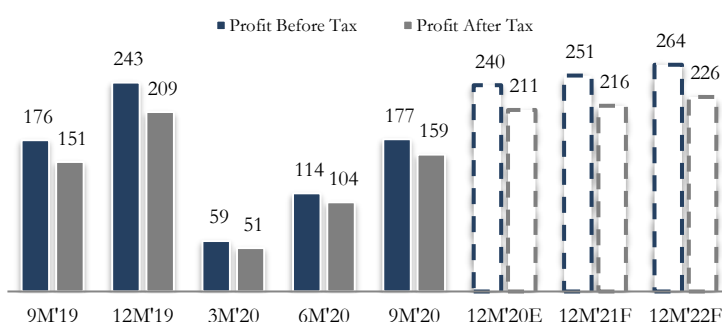
Source: NSE, Company's Results, PAC Research

PBT increases slightly by 0.62% year-on-year, driven by non-interest

income: In nine-month to September 2020, the loan impairment charge of Zenith Bank increased significantly by 37.51% to ₦25.11 billion (vs. ₦18.26 billion nine-month to September 2019), due to the higher expected credit losses on loans and advances. Meanwhile, with lower cost-of-funds and improved interest income line, profit before tax increased marginally by 0.62% to ₦177.28 billion in 9M'20 (vs. ₦176.18 billion reported in 9M'19). However, due to zero provision for dividend tax during the period, the bank made a lower provision of ₦17.97 billion for tax in 9M'20 (9M'19: ₦25.46 billion). As a result, profit after tax improved by 5.70% to ₦159.32 billion in 9M'20 (vs. ₦150.72 billion in 9M'19) and this makes Zenith Bank Plc the best performing bank, in terms of profit after tax, in Nigeria in nine-month to September 2020.

... profit after tax improved by 5.70% to ₦159.32 billion in 9M'20 (vs. ₦150.72 billion in 9M'19) and this makes Zenith Bank Plc the best performing bank...

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



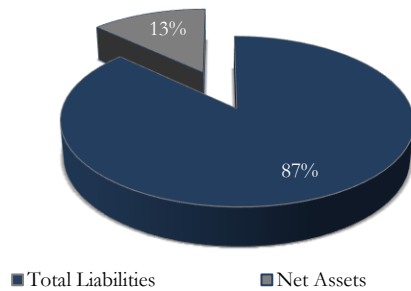
Source: NSE, Bloomberg, PAC Research

Balance sheet remains strong and solid; Expectation of historical final dividend payment in FY'20: In the third quarter of 2020, the balance sheet of the bank remains strong and solid and this can be seen from the robust liquidity ratio and capital adequacy ratio. Liquidity and Capital Adequacy Ratio (CAR) of the bank are well above industry requirements of 30% for liquidity ratio and 16% for capital adequacy ratio. The group's liquidity ratio of the bank improved to 67.40% (Q3'19: 63.82%) while capital adequacy ratio was 21.5% in Q3'20 (Q3'19: 23.80%). However, the loan-to-deposit ratio of 63.2% in Q3'20 (Q3'19: 55.80%) is slightly below the regulatory minimum requirement of 65.00%. Impressively, the non-performing loan ratio of the bank fell to 4.80% in Q3'20 (Q3'19: 4.95%).

Mainly as a result of improved loans and advances, higher treasury bill and higher cash & balances with central banks, total assets increased by 33.37% to ₦7.97 trillion in Q3'20 (vs. ₦5.98 trillion in Q3'19). However, total liabilities increased by 35.88% to ₦6.94 trillion in Q3'20 (vs. ₦5.11 trillion in the corresponding period of previous year), mainly as a result of 32.21% increase in customers deposits. Consequently, the net asset increased by 18.63% to ₦1.03 billion (vs. ₦871.90 billion in Q3'19) and this translated to a net asset per share of ₦32.94 in Q3'20 (Q3'19: ₦27.77). With the robust balance sheet and improved operating performance, the bank may likely reward the shareholders with improved final dividend in FY'20.

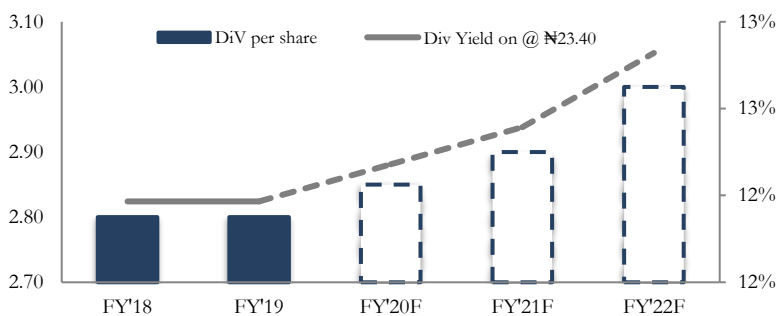
With the robust balance sheet and improved operating performance, the bank may likely reward the shareholders with improved final dividend in FY'20.

Fig. 10: Total Liabilities Vs Net Asset – Q3'20



Source: NSE, Zenith Bank, PAC Research

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



Source: NSE, Zenith Bank, PAC Research

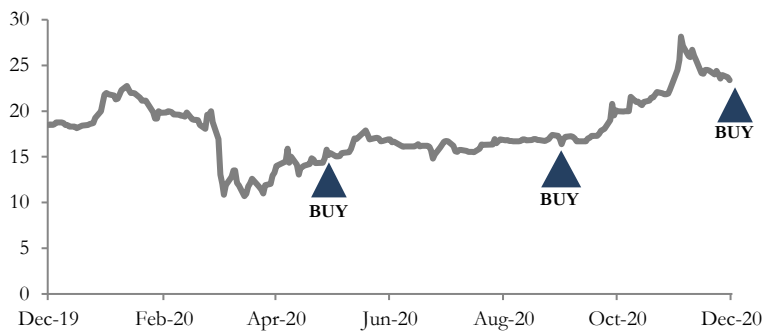
Valuation

Our valuation puts the target price of the stock at ₦28.12, representing an increase of 20.18% from the current price of ₦23.40. In arriving at the target price, we employed Dividend Discount Model and Residual Income Valuation Model. Consequently, we maintain a **BUY** recommendation on the stock of the bank.

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, the performance of the bank in the banking industry, the regulatory environment and outlook from the management.

Our valuation puts the target price of the stock at N28.12, representing an increase of 20.18% from the current price of N23.40.

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	630,344	662,251	682,119	705,993
Change		5.06%	3.00%	3.50%
Interest and Similar Income	440,052	415,563	419,503	434,185
Change		-5.57%	0.95%	3.50%
Interest and Similar Expenses	-144,458	-148,532	-122,781	127,079
Change		2.82%	-17.34%	3.50%
Net Interest Income	295,594	267,031	296,722	307,107
Change		-9.66%	11.12%	3.50%
Impairment Charge for credit losses	-18,372	-24,032	-35,470	-38,124
Change		30.81%	47.60%	7.48%
Net Fees and Comm. Income	81,814	100,106	86,629	91,779
Change		22.36%	-13.46%	5.94%
Trade gains	80,202	117,798	121,417	127,079
Change		46.88%	3.07%	4.66%
Personnel expenses	-68,556	-77,858	-80,490	-83,307
Change		13.57%	3.38%	3.50%
Profit Before Taxation	231,685	243,294	240,106	251,333
Change		5.01%	-1.31%	4.68%
Taxation	-38,261	-34,451	-28,813	-35,187
Change		-9.96%	-16.37%	22.12%
Profit After Taxation	193,424	208,843	211,293	216,147
Change		7.97%	1.17%	2.30%

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

	2018	2019	2020E	2021F
Cash and balances	954,416	936,278	1,841,720	1,906,180
Treasury bills	1,000,560	991,393	1,064,105	1,101,349
Assets pledged as collateral	592,935	431,728	306,953	317,697
Due from other banks	674,274	707,103	886,754	882,491
Derivative assets	88,826	92,722	98,907	102,369
Loans and advances	1,823,111	2,305,565	2,830,792	2,965,169
Investment securities	565,312	591,097	920,860	953,090
Deffered tax assets	9,513	11,860	11,860	13,642
Other assets	80,948	77,395	77,395	136,424
Property and equipment	149,137	185,216	185,216	197,814
Total Assets	5,955,710	6,346,854	8,315,025	8,606,051
Customer deposits	3,690,295	4,262,289	5,456,948	5,647,941
Derivative Liabilities	16,995	14,762	20,464	21,180
Other liabilities	231,716	363,764	750,330	776,592
On lending facilities	393,295	392,871	409,271	423,596
Borrowings	437,260	322,479	545,695	564,794
Debt securities issued	361,177	39,092	54,569	56,479
Total Liabilities	5,139,959	5,404,993	7,252,288	7,506,149
Net Assets	815,751	941,861	1,062,737	1,099,901
Total equity and liabilities	5,955,710	6,346,854	8,315,025	8,606,051

Fig. 15: Profitability Ratio

	2018	2019	2020E	2021F
Return on Equity	23.71%	22.17%	19.88%	19.65%
Return on Assets	3.25%	3.29%	2.54%	2.51%
Net int. income to Rev.	46.89%	40.32%	43.50%	43.50%
PBT margin	36.76%	36.74%	35.20%	35.60%
Net Profit Margin	30.69%	31.54%	30.98%	30.62%
ROCE	5.36%	5.45%	3.88%	3.92%

Fig. 16: Asset Utilisation

	2018	2019	2020E	2021F
Cash/Revenue	151.41%	141.38%	270.00%	270.00%
Revenue to total assets (x)	10.58%	10.43%	8.20%	8.20%
Interest Inc. / Total Assets	7.39%	6.55%	5.05%	5.05%
Other Income/ Total Assets	0.30%	0.22%	0.32%	0.33%
Rev. to total fixed assets	422.66%	357.56%	344.83%	344.83%
fixed asset turnover	23.66%	27.97%	29.00%	29.00%

Fig. 17: Liquidity Ratios

	2018	2019	2020E	2021F
Current ratio	1.16	1.17	1.15	1.15
Cash ratio	0.19	0.17	0.25	0.25
Interest Coverage ratio	1.60	1.64	1.96	1.98
Liquid Assets/Total Deposit	0.68	0.59	0.70	0.70
Loans & Adv./Total Deposit	0.49	0.54	0.52	0.53
Liquid Assets/Total Assets	0.42	0.40	0.46	0.46
Debt/net income	4.13	1.73	2.84	2.87
Debt to asset	0.13	0.06	0.07	0.07
Debt to equity	0.98	0.38	0.56	0.56
Total Liabilities / Total Asset	0.86	0.85	0.87	0.87
Cost to income ratio net interest margin AVERAGED	0.49	0.49	0.52	0.51
Total liabilities/equities	6.30	5.74	6.82	6.82

Fig. 18: Shareholders' Investment Ratios

	2018	2019	2020E	2021F
Earnings per share	6.16	6.65	6.73	6.88
DiV per share	2.80	2.80	2.85	2.90
NAVPS	25.98	30.00	33.85	35.03
Earnings yield	26.33%	28.43%	28.76%	29.42%

Fig. 19: Capital Adequacy Ratios

	2018	2019	2020E	2021F
Loans and Advances/Equity	2.23	2.45	2.66	2.70
Equity/Total Assets	0.14	0.15	0.13	0.13
Loan Loss Expense/ Equity	0.02	0.03	0.03	0.03

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

This research report has been prepared by the analyst(s), whose name(s) appear on the front page of this document, to provide background information about the issues which are the subject matter of this report. It is given for information purposes only.

Each analyst hereby certifies that with respect to the issues discussed herein, all the views expressed in this document are his or her own and reflect his or her personal views about any and all of such matters. These views are not necessarily held or shared by PanAfrican Capital Holdings or any of its affiliate companies. The analyst(s) views herein are expressed in good faith and every effort has been made to base our opinion on reliable comprehensive information but no representation is made as to its accuracy or completeness. The opinions and information contained in this report are subject to change and neither the analysts nor PanAfrican Capital Holdings is under any obligation to notify you or make public any announcement with respect to such change.

This report is produced independently of PanAfrican Capital Holdings and the recommendations (if any), forecasts, opinions, estimates, expectations and views contained herein are entirely those of the analysts. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the recommendations, forecasts, opinions, estimates, expectations and views contained herein are fair and reasonable, none of the analysts, PanAfrican Capital Holdings nor any of its directors, officers or employees has verified the contents hereof and accordingly, none of the analysts, PanAfrican Capital Holdings nor any of its respective directors, officers or employees, shall be in any way responsible for the contents hereof.

With the exception of information regarding PanAfrican Capital Holdings, reports prepared by PanAfrican Capital Holdings analysts are based on public information. Facts and views presented in this report have not been reviewed and may not reflect information known to professionals on other PanAfrican Capital Holdings business areas including investment banking. This report does not provide individually tailored investment advice. Reports are prepared without regard to individual financial circumstances and objectives of persons who receive it. The securities discussed in this report may not be suitable for all investors. It is recommended that investors independently evaluate particular investments and strategies. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances or objectives. Neither the analyst(s), PanAfrican Capital Holdings, any of its respective directors, officers nor employees accepts any liability whatsoever for any loss so ever arising from any use of this report or its contents or otherwise arising in connection therewith. Each analyst and/or any person connected with any analyst may have acted upon or used the information herein contained, or the research or analysis on which it is based prior to its publication date. This document may not be relied upon by any of its recipients or any other person in making investment decisions.

Each research analyst certifies that no part of his or her compensation was, or will be directly or indirectly related to the specific recommendations (if any), opinions, forecasts, estimates or views in this report. Analysts' compensation is based upon activities and services intended to benefit clients of PanAfrican Capital Holdings. As with other employees of PanAfrican Capital Holdings, analysts' compensation is impacted by the overall profitability of PanAfrican Capital Holdings, which includes revenues from all business areas of PanAfrican Capital Holdings.

PanAfrican Capital Holdings Ltd

8A, Elsie Femi Pearse Street

Victoria Island

Lagos, Nigeria

Tel: +234 (1) 2716899, 2718630

www.panafricancapitalholdings.com