

## Outstanding Results: in Line with Expectation as Profit After Tax Hits ₦151 Billion

### INVESTMENT SUMMARY

Zenith Bank delivered another impressive result in nine-month to September 2019 as gross earnings increased by 3.51% to ₦491.27 billion (vs. ₦474.61 billion in nine-month to September 2018). In line with our expectation, non-interest income line is the key contributor to the growth recorded in gross earnings during the period. Non-interest income increased by 21.77% to ₦156.76 billion in 9M'19 (vs. ₦128.73 billion in 9M'18) and the main enabler of this growth was fees from electronic products which doubled to ₦35.32 billion (vs. ₦17.66 billion in 9M'18). However, interest income fell by 5.05% to ₦321.94 billion in 9M'19 (vs. ₦339.06 billion in 9M'18), due to declined yield on money market instruments and drop in average interest rate on loans and advances. As a result of the significant drop in interest expenses on borrowed funds, total interest expenses fell by 2.93% to ₦107.31 billion in 9M'19 (vs. ₦110.55 billion in 9M'18). The bank's effort towards cost optimisation reflected on operating expenses as it remained relatively flat at ₦176.94 billion in 9M'19 (vs. ₦175.61 billion in 9M'18). During the period, impairment charge rose by 27.35% to ₦18.26 billion in 9M'19 (vs. ₦14.34 billion in 9M'18), due to higher expected credit losses on loans and advances.

As a result of higher non-interest income, lower interest expenses and impacted cost optimisation strategies, profit before tax rose by 5.31% to a record ₦176.18 billion in 9M'19 (vs. ₦167.31 billion in 9M'18). A provision of ₦25.46 billion was made for income tax in 9M'19 (vs. ₦23.13 billion in 9M'18) and as a result, profit after tax rose by 4.54% to ₦150.72 billion (vs. ₦144.18 billion in 9M'18). Impressively, 12-month trailing EPS rose to ₦6.37, from ₦6.14 recorded in the previous period. Based on the recent figures released by the bank, we maintain a **BUY** rating on the stock at the current price of ₦17.00 as present forward estimate places the company share price at ₦31.23 (Previous target price: ₦31.75).

Fig. 1: Quarterly results highlights

	3Q2019	2Q2019	3Q2018	Q/q Δ	Y/y Δ
Gross Earnings (₦'mn)	159,682	173,475	157,342	-7.95%	+1.49%
Net Int. Income (₦'mn)	72,112	56,378	74,556	+27.91%	-3.28%
Net profit (₦'mn)	61,841	38,648	62,442	+60.01%	-0.96%

Source: NSE, Bloomberg, PAC Research

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Price:

- Current	₦17.00
- Target	₦31.23

Recommendation: **STRONG BUY**

\* As at Friday November 1, 2019

Fig. 2: Stock data

	December
FYE	
Price Mov't: YtD / 52wk	-26.25% / -27.66%
52-week range	₦26.85 - ₦16.00
30-day Average vol.	43,416,241
Shares Outstanding ('mn)	31,396.49
Market Cap. (₦bn)	533.74
EPS (₦) - 12months trailing	6.37
DPS (₦) - FY2018	2.80

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	9M'19	9M'18
Net Interest Margin	8.69%	9.60%
Net profit margin	30.68%	30.38%
Equity multiplier	6.86	7.22
Cash/ total Assets	15.29%	16.10%

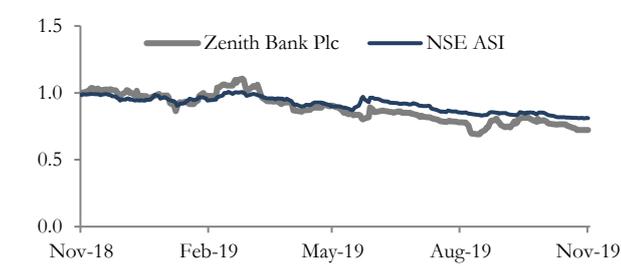
Source: NSE, Bloomberg, PAC Research

Fig. 4: Valuations

	FY2017	FY2018	FY2019F	FY2020F
P/E (x)	3.00	2.76	2.68	2.51
P/B (x)	0.66	0.65	0.61	0.59
Div Yield	15.88%	16.47%	16.76%	17.35%
Payout Ratio	47.64%	45.45%	44.96%	43.53%
EV/Revenue	1.20	1.59	1.63	1.61
Rev per share	23.73	20.08	20.44	21.05
ROE	21.91%	23.71%	22.75%	23.53%
ROA	3.18%	3.25%	3.16%	3.28%

Source: NSE, Bloomberg, PAC Research

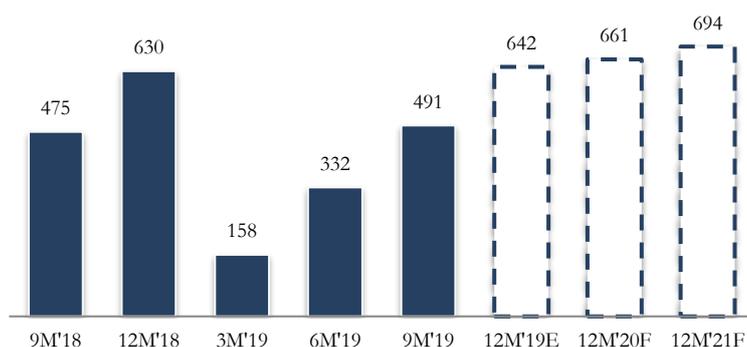
Fig. 5: 52-Week Price Movement of ZENITH vs NSE ASI



Source: Bloomberg, PAC Research

**With higher non-interest income, Gross earnings rises by 3.51%:** Zenith Bank delivered impressive top-line in nine-month to September 2019, as gross earnings increased by 3.51% to ₦491.27 billion (vs ₦474.61 billion in nine-month to September 2018). Non-interest income line of the bank is the key contributor of the growth recorded in gross earnings during the period. Non-interest income rose significantly by 21.77% to ₦156.76 billion in 9M'19 (vs. ₦128.73 billion in 9M'18), due to substantial improvement in inflow from fees and commissions, higher trading income and other operating income. However, total interest income of the bank declined by 5.05% to ₦321.94 billion in nine-month to September 2019 (vs. ₦339.06 billion recorded in nine-month to September 2018). The fall in interest income lines can be mainly attributed to the drop in average interest rate on loans and advances to customers and fall in the yields on money market instruments during the period.

**Fig. 6: Gross Earnings – 9M'18 –12M'21F (Billion NGN)**



Source: NSE, Bloomberg, PAC Research

**Interest income falls by 5.05% year-on-year as a result of lower yields on interest bearing assets:**

In the nine-month to September 2019, average yields declined, particularly in fixed income market (compared with average yields in the previous year) and this resulted to reduction in interest incomes of most banks in Nigeria. Consequently, total interest income of Zenith Bank declined by 5.05% to ₦321.94 billion in 9M'19 (vs. ₦339.06 billion in 9M'18). The setback in total interest income can be mainly attributed to the lower interest income generated from loans & advances to customers and a slight fall in interest income from treasury bills. Interest income from loans and advances to customers fell significantly by 18.16% to ₦175.18 billion in 9M'19 (vs. ₦214.06 billion in 9M'18) while interest income from treasury bills declined slightly by 1.63% to ₦74.27 billion in 9M'19 (vs. ₦75.51 billion in 9M'18). However, the bank reported impressive figures for interest income from government & other bonds and this may be attributed to long term positioning of the bank in fixed income market when rates were high.

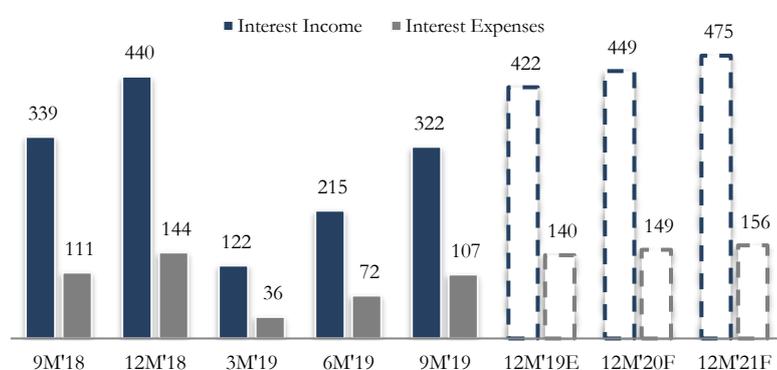
*Non-interest income line of the bank is the key contributor of the growth recorded in gross earnings during the period*

*The setback in total interest income can be mainly attributed to the lower interest income generated from loans & advances to customers and a slight fall in interest income from treasury bills.*

Interest income from government & other bonds increased by 24.48% to ₦49.29 billion in 9M'19 (vs. ₦40.58 billion in 9M'18). In addition, interest income from placement with banks and discount houses rose significantly by 115.37% to ₦11.21 billion in 9M'19 (vs. ₦8.92 billion in 9M'18).

However, the bank benefited from lower yields during the period as interest expenses fell by 2.93% to ₦107.31 billion in 9M'19 (vs. ₦110.55 billion in 9M'18). Interest and similar expenses on time deposits account and borrowed funds declined by 4.99% and 13.00% to ₦31.34 billion (9M'18: ₦32.98 billion) and ₦49.15 billion (9M'18: ₦56.50 billion) in 9M'19 respectively. Due to higher deposits during the period, the bank recorded higher interest expenses on current accounts and savings accounts.

Fig. 7: Interest Income and Interest Expenses: 9M'18-12M'21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research,

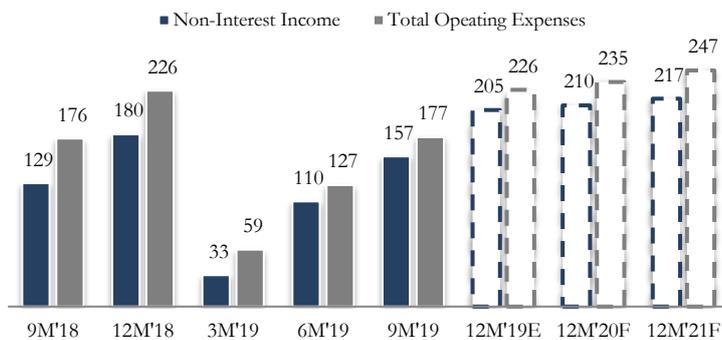
**Non-interest income rises by 21.77% as fees from electronic products doubles:** Zenith Bank recorded a significant growth in non-interest income, expanding by 21.77% to ₦156.76 billion in nine-month to September 2019 (vs. ₦128.73 billion reported in nine-month to September 2018) due to higher inflow from fee & commission and trading income. The increase in fee and commission income can be attributed to higher fees on electronic products, which doubled to ₦35.32 billion in 9M'19, from ₦17.66 billion reported in 9M'18. In addition, higher income from foreign withdrawal charges, improved income from current account maintenance, higher income from treasury bill trading and increased bond trading income contributed to overall non-interest income during the period.

Zenith bank continued to improve its cost optimisation strategies, reflecting in stable operating expenses as it increased marginally by 0.76% to ₦176.94 billion in nine-month to September 2019 (vs. ₦175.61 billion in nine-month to September 2018) and this increase is far below inflation rate of 11.24% reported for the month of September 2019.

*Mainly as a result of 168.69% growth in fees on electronic products and 44.45% in credit related fees, total fee and commission income increased by 35.03%...*

During the period, the increase in personnel expenses, depreciation of property & equipment and amortisation of intangible assets were offset by reduction in other operating expenses as the bank maintained effective cost management. Cost optimization strategies and aggressive retail banking drive yielded desired effects as cost-to-income ratio improved to 50.11% in 9M'19, from 51.20% reported in 9M'18.

Fig. 8: Non-Int. Income & Total Op. Expense: 9M'18-12M'21F (Billion NGN)

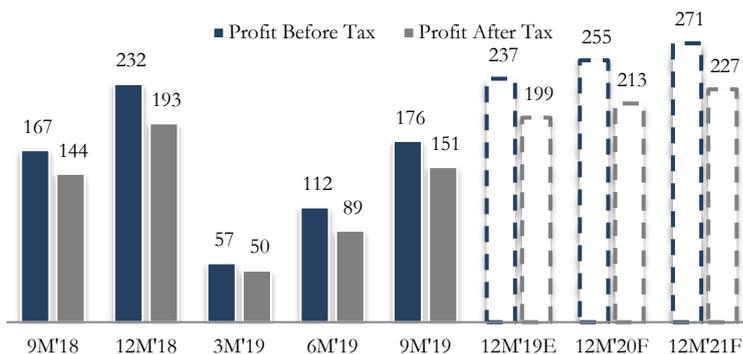


Source: NSE, Company's Results, PAC Research

**With higher non-interest income and effective cost optimisation strategy, Zenith Bank delivers a record PBT:** During the period under review, the bank reported an unimpressive figure for impairment charges as it increased by 27.35% to ₦18.26 billion (vs. ₦14.34 billion in the corresponding period of the previous year). The increase in impairment charges during the period can be mainly ascribed to higher expected credit losses on loans and advances. However, a well managed operating expenses and higher non-interest income offset the unimpressive figures recorded for interest income and higher impairment charges during the period. As a result, profit before tax increased by 5.31% to a record ₦176.18 billion in 9M'19 (vs. ₦167.31 billion reported in 9M'18). The bank made a provision of ₦25.46 billion for income tax during the period (vs. ₦23.13 billion in the corresponding previous period) and this resulted in profit after tax of ₦150.72 billion in 9M'19 (vs. ₦144.18 billion in 9M'18).

*... a well managed operating expenses and higher non-interest income offset the unimpressive figures recorded for interest income and higher impairment charges during the period.*

Fig. 9: Profit before Tax and Profit after Tax – 9M'18-12M'21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

**Balance sheet remains strong and solid; Expectation of improved dividend payment in FY'19:** In addition to the impressive performance of the bank under the income statement, the balance sheet of the bank remains strong and solid in third quarter of 2019. Total assets of the bank increased by 6.42% to ₦5.98 trillion in Q3'19 (vs. ₦5.62 trillion reported in Q3'18) and this can be mainly attributed to 11.96% increase in loans and advances as the bank continued to walk in the direction of achieving new loans-to-deposit ratio of 65.00%, as required by the Central Bank of Nigeria. However, total liabilities of the bank increased by 5.51% to ₦5.11 trillion in Q3'19 (vs. ₦4.84 trillion reported in Q3'18), due to 20.65% increase in customers' deposits. Meanwhile, the increase in the total assets outweighed the increase in bank's total liabilities and this resulted in higher net asset as it increased by 12.08% to ₦871.91 billion in Q3'19 (vs. ₦777.90 billion in Q3'18). Consequently, net asset per share increased to ₦27.77 in Q3'19, from ₦24.78 reported in Q3'18.

The strong balance sheet translated to strong liquidity ratio of 63.82% and capital adequacy ratio of 23.80%. The 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. However, the bank's loan-to-deposit ratio of 55.80% is well below the new regulatory minimum requirement of 65.00%. However, we expect the bank to achieve the regulatory requirement of CBN before the deadline, which is December 31, 2019. With the strong balance sheet and impressive income statement, we expect the bank to pay a final dividend of ₦2.55 in FY'19, having paid an interim dividend of ₦0.30 in the half year of 2019.

*With the strong balance sheet and impressive income statement, we expect the bank to pay a final dividend of ₦2.55 in FY'19, having paid an interim dividend of ₦0.30...*

Fig. 10: Total Liabilities Vs Net Asset in 9M'19

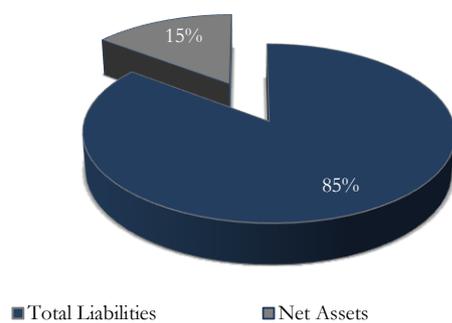
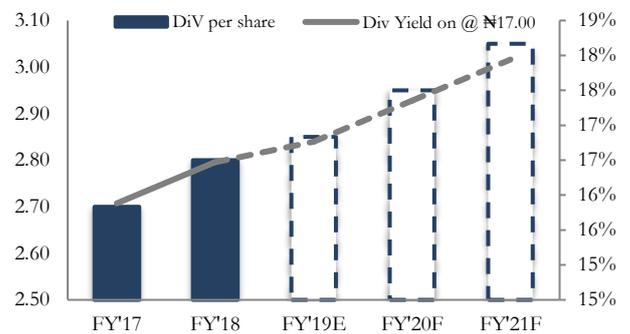


Fig. 11: Dividend Per Share and Dividend Yield (FY'17-FY'21F)



Source: Company's Presentation, PAC Research

## Valuation

Our valuation puts the target price of the stock at ₦31.23, representing an increase of 83.70% from the current price of ₦17.00. In arriving at the target price, we employed 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 company, the current figures released by the company, the performance of the bank in the industry, and outlook from the bank's management.

*Our valuation puts the target price of the stock at N31.23, representing an increase of 83.70% from the current price of N17.00.*

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



Source: NSE, PAC Research

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

	2017	2018	2019E	2020F
Gross Earnings	745,189	630,344	641,690	660,941
Change		-15.41%	1.80%	3.00%
Interest and Similar Income	474,628	440,052	422,232	449,440
Change		-7.28%	-4.05%	6.44%
Interest and Similar Expenses	-216,637	-144,458	-139,824	149,042
Change		-33.32%	-3.21%	6.59%
Net Interest Income	257,991	295,594	282,408	300,398
Change		14.58%	-4.46%	6.37%
Impairment Charge for credit losses	-98,227	-18,372	-24,384	-21,150
Change		-81.30%	32.72%	13.26%
Fees and Commission Income	90,143	81,814	96,254	102,446
Change		-9.24%	17.65%	6.43%
Trade gains	157,974	80,202	89,837	89,227
Change		-49.23%	12.01%	-0.68%
Personnel expenses	-64,459	-68,556	-74,564	-77,991
Change		6.36%	8.76%	4.60%
Profit Before Taxation	203,461	231,685	236,912	254,793
Change		13.87%	2.26%	7.55%
Taxation	-25,528	-38,261	-37,906	-42,041
Change		49.88%	-0.93%	10.91%
Profit After Taxation	177,933	193,424	199,006	212,752
Change		8.71%	2.89%	6.91%

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

	2017	2018	2019E	2020F
Cash and balances	957,663	954,416	962,535	991,411
Treasury bills	936,817	1,000,560	1,039,538	1,070,724
Assets pledged as collateral	468,010	592,935	577,521	594,847
Due from other banks	495,803	674,274	680,192	700,597
Derivative assets	57,219	88,826	93,045	95,836
Loans and advances	2,100,362	1,823,111	2,117,578	2,181,105
Investment securities	330,951	565,312	545,437	561,800
Deffered tax assets	9,561	9,513	11,550	11,897
Other assets	92,494	80,948	87,270	89,888
Property and equipment	133,384	149,137	163,631	171,845
Total Assets	5,595,253	5,955,710	6,294,339	6,486,474
Customer deposits	3,437,915	3,690,295	3,914,310	4,031,739
Derivative Liabilities	20,805	16,995	17,967	18,506
Other liabilities	243,023	231,716	240,634	247,853
On lending facilities	383,034	393,295	399,709	411,700
Borrowings	356,496	437,260	436,349	449,440
Debt securities issued	332,931	361,177	401,056	413,088
Total Liabilities	4,783,137	5,139,959	5,419,715	5,582,307
Net Assets	812,116	815,751	874,624	904,167
Total equity and liabilities	5,595,253	5,955,710	6,294,339	6,486,474

**Fig. 17: Profitability Ratio**

	2017	2018	2019E	2020F
Return on Equity	21.91%	23.71%	22.75%	23.53%
Return on Assets	3.18%	3.25%	3.16%	3.28%
Net int. income to Rev.	34.62%	46.89%	44.01%	45.45%
PBT margin	27.30%	36.76%	36.92%	38.55%
Net Profit Margin	23.88%	30.69%	31.01%	32.19%
ROCE	5.12%	5.36%	5.21%	5.45%

**Fig. 18: Asset Utilisation**

	2017	2018	2019E	2020F
Cash/Revenue	128.51%	151.41%	150.00%	150.00%
Revenue to total assets (x)	13.32%	10.58%	10.19%	10.19%
Interest Inc. / Total Assets	8.48%	7.39%	6.71%	6.93%
Other Income/ Total Assets	0.40%	0.30%	0.31%	0.29%
Rev. to total fixed assets	558.68%	422.66%	392.16%	384.62%
fixed asset turnover	17.90%	23.66%	25.50%	26.00%

**Fig. 19: Liquidity Ratios**

	2017	2018	2019E	2020F
Current ratio	1.17	1.16	1.16	1.16
Cash ratio	0.20	0.19	0.18	0.18
Interest Coverage ratio	0.94	1.60	1.69	1.71
Liquid Assets/Total Deposit	0.65	0.68	0.65	0.65
Loans & Adv./Total Deposit	0.61	0.49	0.54	0.54
Liquid Assets/Total Assets	0.40	0.42	0.40	0.40
Debt/net income	3.87	4.13	4.21	4.05
Debt to asset	0.12	0.13	0.13	0.13
Debt to equity	0.85	0.98	0.96	0.95
Total Liabilities / Total Asset	0.85	0.86	0.86	0.86
Cost to income ratio net interest margin AVERAGED	0.53	0.49	0.49	0.48
Total liabilities/equities	5.89	6.30	6.20	6.17

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

	2017	2018	2019E	2020F
Earnings per share	5.67	6.16	6.34	6.78
DiV per share	2.70	2.80	2.85	2.95
NAVPS	25.87	25.98	27.86	28.80
Earnings yield	33.34%	36.24%	37.29%	39.86%

**Fig. 21: Capital Adequacy Ratios**

	2017	2018	2019F	2020F
Loans and Advances/Equity	2.59	2.23	2.42	2.41
Equity/Total Assets	0.15	0.14	0.14	0.14
Loan Loss Expense/ Equity	0.12	0.02	0.03	0.02

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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