Zenith Bank Plc

PAC Research

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Impressive Performance as Non-Interest Income and Lower Cost of Funds Boost Profitability

INVESTMENT SUMMARY

Zenith Bank continued with stellar performance in nine-month to September 2021 as gross earnings of the bank increased by 1.91% to ₦518.67 billion (vs. ₦508.98 billion in nine-month to September 2020), driven mainly by the higher non-interest income during the period. The non-interest income of the bank rose by 11.11% to ₦192.77 billion in 9M’21 (vs. ₦173.49 billion in 9M’20), largely due to the growth recorded in current account maintenance fees and improved fees from electronic products during the period. However, the total interest income of the bank fell by 3.13% to ₦308.84 billion in 9M’21 (vs. ₦318.82 billion in 9M’20), mainly because of reduction in yield on assets. Impressively, the bank benefited from the lower interest rates, which reflected on cost of funds of 1.40% in 9M’21 (9M’20: 2.20%), as interest & similar expense fell significantly by 20.87% to ₦74.10 billion (vs. ₦93.64 billion in 9M’20). Despite the lower loan-to-deposit ratio of 60.20%, the bank’s loan impairment charge increased by 14.70% to ₦28.80 billion in 9M’21 (vs. ₦25.11 billion in 9M’20).

With the impressive non-interest income and lower interest and similar expenses recorded during the period, the profit before tax (PBT) improved slightly by 1.43% to ₦179.81 billion in 9M’21 (vs. ₦177.28 billion in 9M’20). However, the bank made a higher provision of ₦19.22 billion for income tax in 9M’21 (vs. ₦17.97 billion in 9M’20). Notwithstanding the higher tax provision, profit after tax (PAT) grew marginally by 0.80% to ₦160.59 billion in 9M’21 (vs. ₦159.32 billion in 9M’20) and this resulted in a 12-month trailing earnings per share (EPS) of ₦7.38 (vs. ₦6.93 recorded in the previous corresponding period). Based on the recently released figures, we maintain a **BUY** rating on the stock at the current price of ₦24.00 as present forward estimate places the company share price at ₦30.98 (Previous target price: ₦30.82).

Table 1: Quarterly results highlights

	3Q2021	2Q2021	3Q2020	Q/q Δ	Y/y Δ
Gross Earnings (₦’mn)	173,114	188,250	162,887	-8.04%	+6.28%
Net Int. Income (₦’mn)	74,806	74,503	67,770	+0.41%	+10.38%
Net profit (₦’mn)	54,475	53,059	55,489	+2.67%	-1.83%

Source: NSE, Bloomberg, PAC Research

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Price:	
- Current	**₦24.00**
- Target	**₦30.98**
Recommendation:	**BUY**

** As at Thursday November 11, 2021*

Table 2: Stock data

FYE	December
Price Mov’t: YtD / 52wk	-3.23%/-2.04%
52-week range	₦28.50 - ₦19.50
30-day Average vol.	10,203,230
Shares Outstanding ('mn)	31,396.49
Market Cap. (₦bn)	753.52
EPS (₦) – 12 Months Trailing	7.38
DPS (₦) - FY2020	3.00

Source: NSE, Bloomberg, PAC Research

Table 3: Key ratios

	9M'21	9M'20
Net Interest Margin	6.80%	8.30%
Net profit margin	30.96%	31.30%
Equity multiplier	7.37	7.71
Cash/ total Assets	18.07%	22.56%

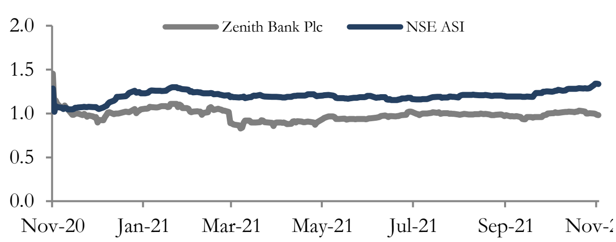
Source: NSE, Bloomberg, PAC Research

Tab 3: Valuations

	FY2019	FY2020	FY2021E	FY2022F
P/E (x)	3.61	3.27	3.27	3.19
P/B (x)	0.80	0.67	0.61	0.59
Div Yield	11.67%	12.50%	12.50%	12.71%
Payout Ratio	42.09%	40.85%	40.85%	40.57%
EV/Revenue	1.41	1.67	1.04	0.98
Rev per share	21.09	22.18	22.40	23.19
ROE	22.17%	20.63%	18.74%	18.35%
ROA	3.29%	2.72%	2.56%	2.51%

Source: NSE, Bloomberg, PAC Research

Fig. 1: 52-Week Price Movement of ZENITH vs NSE ASI



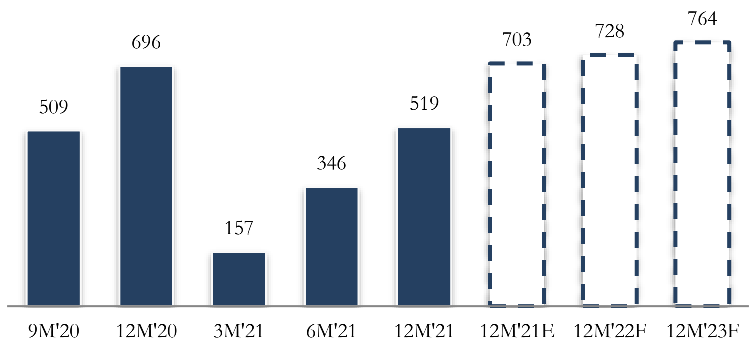
Source: Bloomberg, PAC Research

…the total interest income of the bank declined by 3.13% to ₦308.84 billion in 9M'21 (vs. ₦318.82 billion in 9M'20).

Gross earnings improves by 1.91% year-on-year, driven by non-interest income: Notwithstanding the economic uncertainties in the country, Zenith Bank continued to report impressive top-line as gross earnings improved by 1.91% to ₦518.67 billion in nine-month to September 2021 (vs ₦508.78 billion in nine-month to September 2020). The increase in the gross earnings of the bank during the period was mainly driven by improved performance from the non-interest income lines. The bank's non-interest income increased by 11.11% to ₦192.77 billion in 9M'21 (vs. ₦173.49 billion in 9M'20), largely driven by the growth in current account maintenance fees, as well as fees from electronic products during the period. However, the total interest income of the bank declined by 3.13% to ₦308.84 billion in 9M'21 (vs. ₦318.82 billion in 9M'20). The decline in total interest income of the bank was mainly ascribed to the decline in yield on assets, reflecting current money market realities which resulted in lower interest income from treasury bills during the period.

We may likely see a marginal growth in the top-line in the full year of 2021, as we expect the non-interest income line of the bank to continue to drive the gross earnings

Fig. 2: Grosss Earnings – 9M'20 –12M'23F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Total interest income falls by 3.13% year-on-year, due to a decline in yield on assets: In nine-month to September 2021, the total interest income of Zenith Bank declined by 3.13% to ₦308.84 billion in 9M'21 (vs. ₦318.82 billion in 9M'20), driven by lower yields in money market during the period. The lower yields in money market resulted in lower interest income from treasury bills, which fell by 21.80% to ₦31.59 billion in 9M'21 (9M'20: ₦40.39 billion). Also, the interest income from placement with banks and discount houses declined significantly by 66.81% to ₦7.39 billion in 9M'21 (9M'20: ₦22.27 billion). However, the fall in interest income from treasury bills and placement with banks and discount houses was partially mitigated by growth in interest income from loans and advances which improved by 9.23% to ₦206.86 billion in 9M'21 (9M'20: ₦189.39 billion).

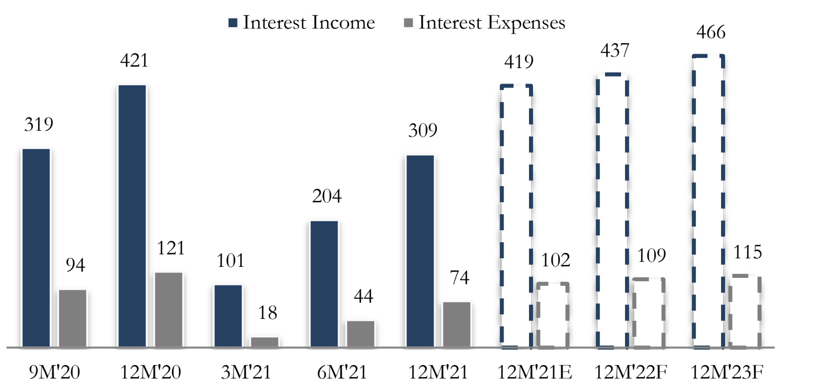
In addition, the bank continued to enjoy long term position taken in the bond market when rates were high, as interest income from government and other bonds increased by 2.01% to ₦61.86 billion in 9M'21 (9M'20: ₦60.64 billion).

However, Zenith Bank benefited from the lower yield environment in the nine-month to September 2021 as cost of funds fell by 80 bps to 1.40% (9M'20: 2.20%). As a result, the interest and similar expenses of the bank fell by 20.87% to ₦74.10 billion in 9M'21 (vs. ₦93.64 billion reported in 9M'20). Specifically, the reduction in interest and similar expenses could be mainly attributed to the fall in interest expenses on current account, savings account, time deposit and borrowed fund by 21.58%, 63.59%, 26.45% and 6.32%, respectively. Meanwhile, the decline in the interest expenses of the bank outweighed the setback recorded in interest income. Thus, the net interest income of the bank improved by 4.25% to ₦234.75 billion in 9M'21 (vs. ₦225.18 billion reported in 9M'20).

Due to the expectation of slight reduction in yields on short term instruments, we may continue to see a decline in interest income in the fourth quarter of 2021.

Due to the expectation of slight reduction in yields on short term instruments, we may continue to see a decline in interest income in the fourth quarter of 2021. However, this would be mitigated by lower interest expenses as we anticipated further reduction in the cost of funds.

Fig. 3: Interest Income and Interest Expenses: 9M'20-12M'23F (Billion NGN)



Source: NSE, Bloomberg, PAC Research,

Non-interest income improves by 11.11%, driven by growth in fee from current account maintenance and electronic products: In the period under review, the total non-interest income of the bank improved by 11.11% to ₦192.77 billion in 9M'21 (vs. ₦173.49 billion in 9M'20), driven mainly by the significant improvement in income on fee and commission which increased by 25.82% to ₦95.36 billion in 9M'21 (vs. ₦75.79 billion in 9M'20). The increase in income on fee and commission could be mainly attributed to the 41.91% increase in income from current account maintenance and 29.94% rise in fees on electronic products.

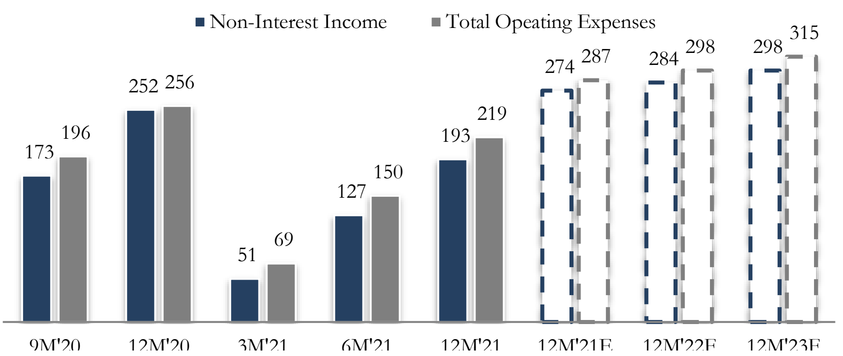
However, the trading income was relatively flat at ₦90.66 billion in 9M'21 (when compared with the ₦89.82 billion reported in 9M'20) as the significant gain recorded in derivative trading was offset by the setback recorded in trading income from treasury bills and bonds during the period.

Meanwhile, the total operating expenses of the bank increased by 11.53% to ₦218.91 billion in 9M'21 (vs. ₦196.28 billion in 9M'20), due to higher expenses on insurance premium, information technology, outsourcing services, fuel and maintenance, AMCON expenses, among others. Impressively, the 11.53% increase in total operating expenses in nine-month to September 2021 is 510 bps lower than the inflation rate of 16.63% for the month of September 2021.

With improved financial inclusion and increased fintech awareness, we may continue to see improvement in electronic products in the fourth quarter of 2021.

With improved financial inclusion and increased fintech awareness, we may continue to see improvement in electronic products in the fourth quarter of 2021. However, the new Payment Service Bank (PSB) licences, recently given to MTN and Airtel, is a major threat to the non-interest income line of banks going forward.

Fig. 4: Non-Int. Income & Total Op. Expense: 9M'20-12M'23F (Billion NGN)

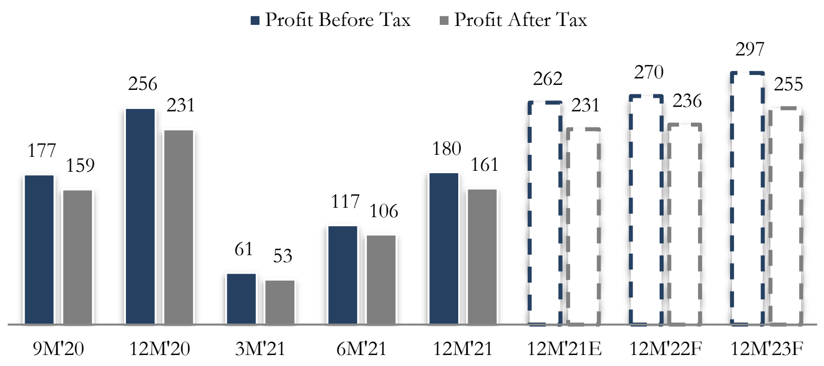


Source: NSE, Company's Results, PAC Research

PBT grows by 1.43% year-on-year, driven by non-interest income and lower cost of funds: In nine-month to September 2021, the loan impairment charge of Zenith Bank increased by 14.70% to ₦28.80 billion (vs. ₦25.11 billion nine-month to September 2020), due to the higher expected credit losses on loans and advances and higher impairment charge on other financial assets. Meanwhile, the lower cost-of-funds and improved non-interest income outweighed the setback recorded in interest income line and higher impairment charge. Consequently, the PBT grew marginally by 1.43% to ₦179.81 billion in 9M'21 (vs. ₦177.28 billion reported in 9M'20). However, the bank made a higher provision of ₦19.22 billion for tax in 9M'21 (9M'20: ₦17.97 billion). Despite the increase in tax provision, the PAT increased marginally by 0.80% to ₦160.59 billion in 9M'21 (vs. ₦159.32 billion in 9M'20)) and this resulted in a 12-month trailing earnings per share (EPS) of ₦7.38 during the period

Despite the increase in tax provision, the PAT increased marginally by 0.80% to ₦160.59 billion in 9M'21 (vs. ₦159.32 billion in 9M'20)…

Fig. 5: Profit before Tax and Profit after Tax – 9M'20-12M'23F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Balance sheet remains strong and healthy; Expectation of historical final dividend payment in FY'21: In the third quarter of 2021, the balance sheet of the bank remained strong and solid, and this is manifested in the robust liquidity ratio and capital adequacy ratio. Liquidity Ratio and Capital Adequacy Ratio (CAR) of the bank are well above industry requirements of 30% for liquidity ratio and 16% for CAR. The group's liquidity ratio stood at 52.90% in Q3'21 (Q3'20: 67.40%) while the CAR was 20.10% in Q3'21 (Q3'20: 21.5%). However, the loan-to-deposit ratio of 60.20% in Q3'21 (Q3'20: 63.2%) is below the regulatory minimum requirement of 65.00% and this may be attributed to the effort of the bank to avoid bad loans. This yielded positive result on the bank's non-performing loan ratio which declined to 4.50% in Q3'21 (Q3'20: 4.80%).

The total assets increased by 9.76% to ₦8.75 trillion in Q3'21 (vs. ₦7.97 trillion in Q3'20), mainly as a result of 68.90% increase in treasury bills and 11.41% rise in loans and advances. However, total liabilities increased by 9.02% to ₦7.56 trillion in Q3'21 (vs. ₦6.94 trillion in the corresponding period of previous year), largely due to 15.62% increase in customers deposits. Consequently, the net asset increased by 14.76% to ₦1.19 trillion in Q3'21 (vs. ₦1.03 trillion in Q3'20) and this translated to a net asset per share of ₦37.81 in Q3'21 (Q3'20: ₦32.94). With the robust balance sheet and expectation of impressive operating performance in Q4'21, the bank may likely equal the last final dividend paid (which is ₦2.70 in the previous financial year) in FY'21.

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Fig. 6: Total Liabilities Vs Net Asset – Q3'21

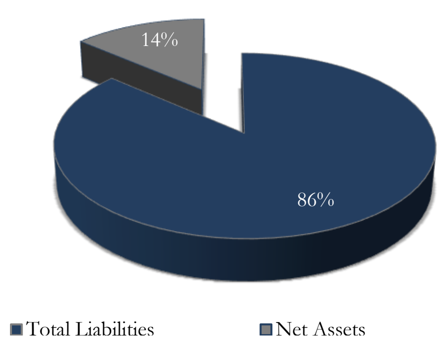
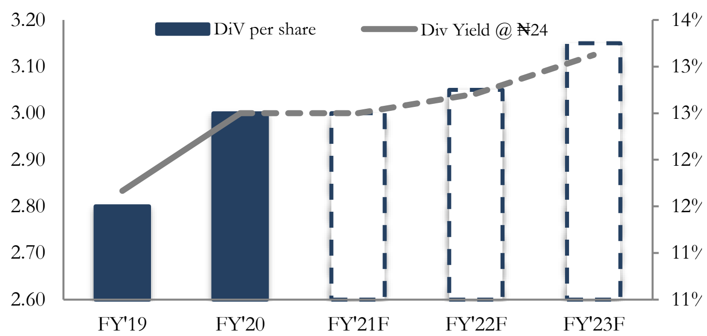


Fig. 7: Dividend Per Share and Dividend Yield (FY'19-FY'23F)



Source: NSE, Zenith Bank, PAC Research

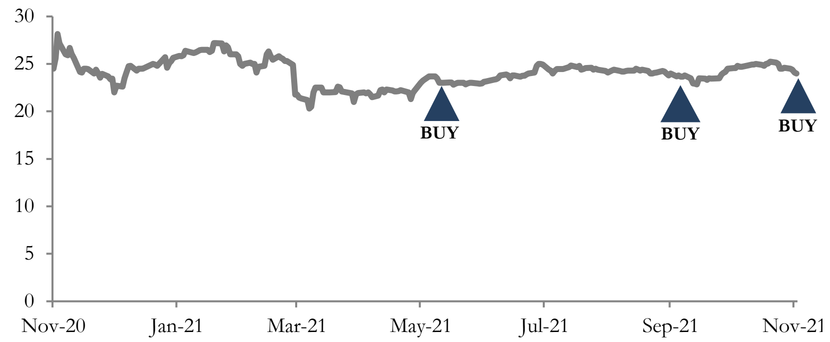
Valuation

Our valuation puts the target price of the stock at ₦30.98, representing an increase of 29.08% from the current price of ₦24.00. 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 N30.98, representing an increase of 29.08% from the current price of N24.00.

Fig. 8: Share Price History (Naira)



Source: NSE, PAC Research

Table 5: Statement of Profit or Loss, N'mn

	2019	2020	2021E	2022F
Gross Earnings	696,450	703,415	728,034	764,436
Change	10.49%	1.00%	3.50%	5.00%
Interest and Similar Income	420,813	418,532	436,820	466,306
Change	-4.37%	-0.54%	4.37%	6.75%
Interest and Similar Expenses	-121,131	-101,995	-109,205	-114,665
Change	-16.15%	-15.80%	7.07%	5.00%
Net Interest Income	299,682	316,537	327,615	351,640
Change	1.38%	5.62%	3.50%	7.33%
Impairment Charge for credit losses	-39,534	-42,205	-43,682	-38,222
Change	115.19%	6.76%	3.50%	-12.50%
Net Fees and Comm. Income	79,332	109,029	112,845	118,488
Change	-3.03%	37.43%	3.50%	5.00%
Trade gains	121,678	126,615	131,046	137,598
Change	51.71%	4.06%	3.50%	5.00%
Personnel expenses	-79,258	-80,541	-83,360	-87,528
Change	15.61%	1.62%	3.50%	5.00%
Profit Before Taxation	255,861	262,022	269,737	296,983
Change	10.43%	2.41%	2.94%	10.10%
Taxation	-25,296	-31,443	-33,717	-41,578
Change	-33.89%	24.30%	7.23%	23.31%
Profit After Taxation	230,565	230,579	236,020	255,406
Change	19.20%	0.01%	2.36%	8.21%

Table. 6: Statement of Financial Position, N'mn

	2019	2020	2021E	2022F
Cash and balances	1,591,768	1,642,500	1,738,020	1,807,541
Treasury bills	1,577,875	1,762,069	1,644,073	1,709,836
Assets pledged as collateral	298,530	316,442	330,682	343,909
Due from other banks	810,494	589,754	845,523	879,344
Derivative assets	44,496	69,224	49,288	51,260
Loans and advances	2,779,027	3,125,875	3,172,592	3,299,496
Investment securities	996,916	1,056,731	1,104,284	1,148,455
Deffered tax assets	5,786	11,860	6,133	6,409
Other assets	169,967	77,395	202,278	234,868
Property and equipment	190,170	185,216	201,580	250,839
Total Assets	8,481,272	8,990,148	9,394,705	9,770,493
Customer deposits	5,339,911	6,113,301	6,388,399	6,643,935
Derivative Liabilities	11,076	11,741	12,269	12,760
Other liabilities	703,292	494,458	516,709	537,377
On lending facilities	384,573	407,647	425,992	443,031
Borrowings	870,080	674,261	704,603	732,787
Debt securities issued	43,177	45,768	47,827	49,740
Total Liabilities	7,363,799	7,759,567	8,108,748	8,433,098
Net Assets	1,117,473	1,230,581	1,285,957	1,337,396
Total equity and liabilities	8,481,272	8,990,148	9,394,705	9,770,493

Tab. 7: Profitability Ratio

	2019	2020	2021E	2022F
Return on Equity	20.63%	18.74%	18.35%	19.10%
Return on Assets	2.72%	2.56%	2.51%	2.61%
Net int. income to Rev.	43.03%	45.00%	45.00%	46.00%
PBT margin	36.74%	37.25%	37.05%	38.85%
Net Profit Margin	33.11%	32.78%	32.42%	33.41%
ROCE	4.10%	4.01%	3.95%	4.19%

Tab. 8: Asset Utilisation

	2019	2020	2021E	2022F
Cash/Revenue	228.55%	233.50%	238.73%	236.45%
Revenue to total assets (x)	8.21%	7.82%	7.75%	7.82%
Interest Inc. / Total Assets	4.96%	4.66%	4.65%	4.77%
Other Income/ Total Assets	0.60%	0.43%	0.43%	0.43%
Rev. to total fixed assets	366.22%	348.95%	290.24%	293.03%
fixed asset turnover	27.31%	28.66%	34.45%	34.13%

Table 9: Liquidity Ratios

	2019	2020	2021E	2022F
Current ratio	1.15	1.16	1.16	1.16
Cash ratio	0.22	0.21	0.21	0.21
Interest Coverage ratio	2.11	2.57	2.47	2.59
Liquid Assets/Total Deposit	0.78	0.73	0.70	0.70
Loans & Adv./Total Deposit	0.52	0.51	0.50	0.50
Liquid Assets/Total Assets	0.49	0.50	0.48	0.48
Debt/net income	3.96	3.12	3.19	3.06
Debt to asset	0.11	0.08	0.08	0.08
Debt to equity	0.82	0.59	0.59	0.59
Total Liabilities / Total Asset	0.87	0.86	0.86	0.86
Cost to income ratio	0.50	0.52	0.53	0.51
net interest margin AVERAGED	0.06	0.07	0.05	0.06
Total liabilities/equities	6.59	6.31	6.31	6.31

Table 10: Shareholders' Investment Ratios

	2019	2020	2021E	2022F
Earnings per share	7.34	7.34	7.52	8.13
DiV per share	3.00	3.00	3.05	3.15
NAVPS	35.59	39.19	40.96	42.60
Earnings yield	30.60%	30.60%	31.32%	33.90%

Table 11: Capital Adequacy Ratios

	2019	2020	2021E	2022F
Loans and Advances/Equity	2.49	2.54	2.47	2.47
Equity/Total Assets	0.13	0.14	0.14	0.14
Loan Loss Expense/ Equity	0.04	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

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