Zenith Bank Plc

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Nigeria | Equities | Financial Services | February 28, 2020 — PAC RESEARCH

Impressive Result as Non-interest Income Lifts Profit After Tax to ₦209 Billion

INVESTMENT SUMMARY

The consistency in delivering an impressive result continued as Zenith Bank increased gross earnings by 5.06% to ₦662.25 billion in 2019 (vs. ₦630.34 billion in 2018). The growth of gross earnings can be mainly attributed to improvement in the non-interest income line as it grew significantly by 28.98% to ₦232.12 billion in FY'19 (vs. ₦179.96 billion in FY'18). However, interest income declined by 5.57% to ₦415.56 billion in FY'19 (vs. ₦440.05 billion in FY'18), due to lower yield on money market instruments and declined average interest rate on loans and advances. Total interest expenses fell by 2.82% to ₦148.53 billion in FY'19 (vs. ₦144.46 billion in FY'18), as a result of the significant drop in interest expenses on borrowed funds and lease. Although, operating expenses rose marginally by 2.80% to ₦231.83 billion in FY'19 (vs. ₦225.50 billion in FY'18), the bank's effort towards cost optimisation cannot be undermined as cost-to-income ratio fell to 48.80% in FY'19, from 49.30% recorded in FY'18. Due to higher expected credit losses on loans and advances, impairment charge rose by 30.81% to ₦24.03 billion in FY'19 (vs. ₦18.37 billion in FY'18).

With higher non-interest income and impacted cost optimisation strategies, profit before tax rose by 5.01% to ₦243.29 billion in FY'19 (vs. ₦231.69 billion in FY'18). A lower provision of ₦34.45 billion was made for tax in FY'19 (vs. ₦38.26 billion in FY'18) and as a result, profit after tax rose by 7.97% to ₦208.84 billion (vs. ₦193.42 billion in FY'18). Impressively, EPS rose to ₦6.65 in 2019, from ₦6.15 recorded in 2018. The bank proposed a final dividend of ₦2.50 per share (2018 Final dividend: ₦2.50) 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: ₦2.80). Based on the recent figures released by the bank, we maintain a **BUY** rating on the stock at the current price of ₦18.50 as present forward estimate places the company share price at ₦25.48

Fig. 1: Quarterly results highlights

	4Q2019	3Q2019	4Q2018	Q/q Δ	Y/y Δ
Gross Earnings (₦'mn)	170,983	159,682	155,737	+7.08%	+9.79%
Net Int. Income (₦'mn)	52,404	72,112	67,077	-27.33%	-21.87%
Net profit (₦'mn)	58,120	61,841	49,245	-6.02%	+18.02%

Source: NSE, Bloomberg, PAC Research

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Price:

- Current	**₦19.00**
- Target	**₦25.48**
Recommendation:	**STRONG BUY**

** As at Friday February 28, 2020*

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-0.54%/-28.29%
52-week range	₦26.20 - ₦16.00
30-day Average vol.	41,429,270
Shares Outstanding ('mn)	31,396.49
Market Cap. (₦bn)	580.83
EPS (₦)	6.65
DPS (₦) - FY2019	2.80

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	FY'19	FY'18
Net Interest Margin	8.20%	8.90%
Net profit margin	31.54%	30.69%
Equity multiplier	6.74	7.30
Cash/ total Assets	14.75%	16.03%

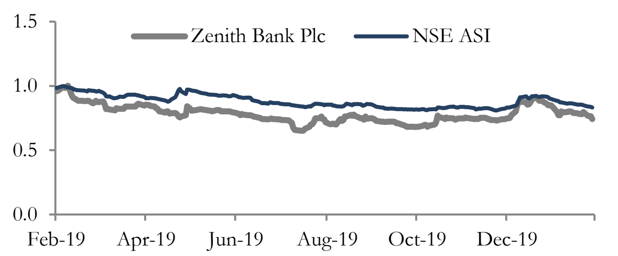
Source: NSE, Bloomberg, PAC Research

Fig. 4: Valuations

	FY2018	FY2019	FY2020F	FY2021F
P/E (x)	3.00	2.78	2.84	2.76
P/B (x)	0.71	0.62	0.55	0.53
Div Yield	15.14%	15.14%	15.41%	15.68%
Payout Ratio	45.45%	42.09%	43.68%	43.33%
EV/Revenue	1.69	1.18	1.17	1.15
Rev per share	20.08	21.09	21.41	21.84
ROE	23.71%	22.17%	19.31%	19.26%
ROA	3.25%	3.29%	3.07%	3.09%

Source: NSE, Bloomberg, PAC Research

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



Source: Bloomberg, PAC Research

Gross earnings rises by 5.06% year-on-year due to high non-interest income: In the twelve-month to December 2019, Zenith Bank delivered impressive result as gross earnings increased by 5.06% to ₦662.25 billion (vs ₦630.34 billion recorded in the twelve-month to December 2018). The key contributor of the growth recorded in gross earnings during the period is non-interest income line of the bank. Non-interest income rose significantly by 28.98% to ₦232.12 billion in FY'19 (vs. ₦179.96 billion in FY'18), due to substantial improvement in inflows from fees & commissions and higher trading income. However, total interest income of the bank declined by 5.57% to ₦415.56 billion in twelve-month to December 2019 (vs. ₦440.05 billion recorded in twelve-month to December 2018). The fall in interest income lines can be mainly attributed to various policies by the monetary authority which led 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.

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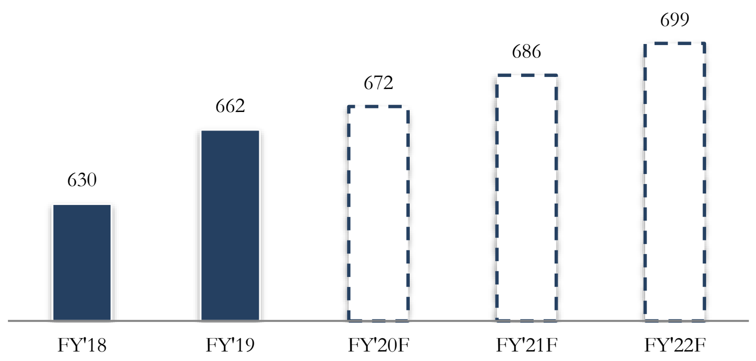
Fig. 6: Grosss Earnings – FY'18 – FY'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

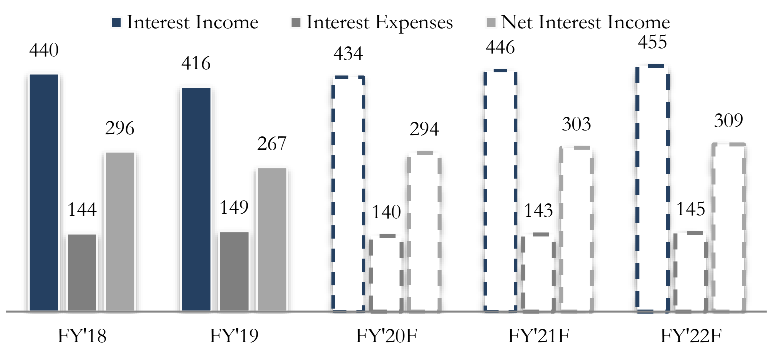
As a result of lower yields on interest bearing assets, interest income falls by 5.05%: Various policies by the monetary authority, particularly in the second half of 2019, led to the fall in the average yields in the market and this resulted to reduction in interest incomes of most banks in Nigeria in 2019. Zenith Bank was not left out as total interest income fell by 5.57% to ₦415.56 billion in FY'19 (vs. ₦440.05 billion in FY'18). The setback in total interest income can be mainly attributed to the lower interest income generated from loans & advances to customers and fall in interest income from treasury bills during the period. Interest income from loans and advances to customers fell significantly by 14.73% to ₦232.95 billion in FY'19 (vs. ₦273.18 billion in FY'18) while interest income from treasury bills also declined significantly by 19.33% to ₦81.11 billion in FY'19 (vs. ₦100.54 billion in FY'18).

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

On the other hand, the bank reported impressive figures for interest income from government & other bonds, interest income from placement with banks & discount houses and interest income from promissory note.
Interest income from government & other bonds increased by 30.59% to ₦68.50 billion in FY'19 (vs. ₦52.45 billion in FY'18) and this may be attributed to long term positioning of the bank in fixed income market when rates were high. In addition, interest income from placement with banks and discount houses doubled as it increased by 115.37% to ₦26.90 billion in FY'19 (vs. ₦13.89 billion in FY'18). Going forward, we expect moderate growth in interest income due to the mixture of new minimum loan-to-deposit ratio requirement and lower interest rate environment.

Meanwhile, the bank benefited from lower yields during, particularly in the second half of 2019, as interest expenses fell by 2.82% to ₦148.53 billion in FY'19 (vs. ₦144.46 billion in FY'18). Interest and similar expenses borrowed funds and lease declined by 6.29% to ₦67.95 billion in FY'19 (vs. ₦72.51 billion in FY'18). On the other hand, the bank recorded higher interest expenses on current accounts, savings accounts and time deposit accounts due to higher deposits during the period.

Fig. 7: Interest Income and Interest Expenses: FY'18-FY'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research,

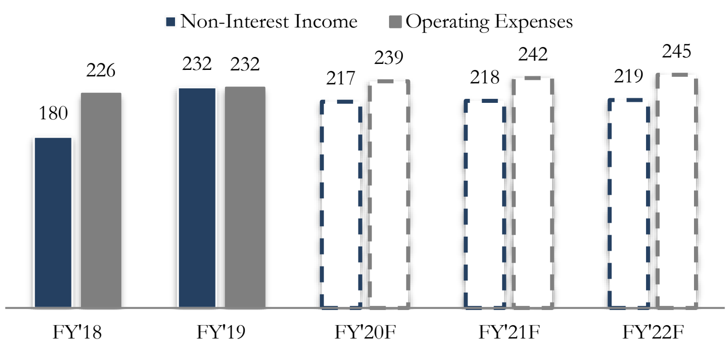
Fees on electronic products lifts non-interest income by 28.98%: In 2019**,** Zenith Bank recorded a significant growth in the non-interest income, which expanded by 28.98% to ₦232.12 billion in twelve-month to December 2019 (vs. ₦179.96 billion reported in twelve-month to December 2018) due to higher inflows from fee & commission income and trading income. Fee and commission income increased by 24.45% to ₦114.67 billion (vs. ₦92.14 billion in FY'18) while trading income rose significantly by 46.88% ₦117.80 billion in FY'19 (vs. ₦80.20 billion reported in FY'18). The significant increase in fee and commission income can be ascribed to higher fees on electronic products, which increased by 108.16% to ₦42.51 billion in FY'19, (vs. ₦20.42 billion reported in FY'18).

In addition, there was an improvement in income from credit related fees, account maintenance fee, foreign currency transaction fees & commission and income from foreign withdrawal charges. For trading income, lower derivative loss, higher income from treasury bills and bond trading are the key contributors to the significant increase recorded in this income line.

However, operating expenses increased marginally by 2.80% to ₦231.83 billion in FY'19 (vs. ₦225.50 billion in FY'18) due to increase in personnel expenses, expenses on deposit insurance premium, higher payment for outsourcing services, among others. Although, operating expenses rose by 2.80%, the bank's effort towards cost optimisation cannot be undermined as cost-to-income ratio fell to 48.80% in FY'19, from 49.30% recorded in FY'18. Also, the increase operating expenses is far below the inflation rate of 11.98% which was reported for the month of December 2019.

Although, operating expenses rose by 2.80%, the bank's effort towards cost optimisation cannot be undermined as cost-to-income ratio fell to 48.80% in FY'19…

Fig. 8: Non-Int. Income & Total Op. Expense: FY'18 - FY'22F (Billion NGN)



Source: NSE, Company's Results, PAC Research

Higher non-interest income and effective cost optimisation strategy lift PAT to ₦208.84: In addition to lower interest income achieved during the period, the bank reported an unimpressive figure for impairment charges as it increased by 30.81% to ₦24.03 billion (vs. ₦18.37 billion in 2018), due to higher expected credit losses on loans and advances. This is in line we our projection as we expect the new minimum loan-to-deposit ratio requirement by the CBN to have adverse effects on the non-performing loans of the banks. However, the benefit derived from lower cost of funds and higher non-interest income offset the lower interest income and higher impairment charge during the period. Consequently, profit before tax increased by 5.01% to ₦243.29 billion in FY'19 (vs. ₦231.69 billion reported in FY'18). The bank made a lower provision of ₦34.45 billion for tax during the period (FY'19: ₦38.26 billion) and as a result, profit after tax increased by 7.97% to ₦208.84 billion in FY'19 (vs. ₦193.42 billion in FY'18). The profit after tax of ₦208.84 billion is a remarkable figure as no bank has ever achieved this number in Nigeria. Impressively, EPS improved by 8.13% to ₦6.65, from ₦6.15 recorded in 2018.

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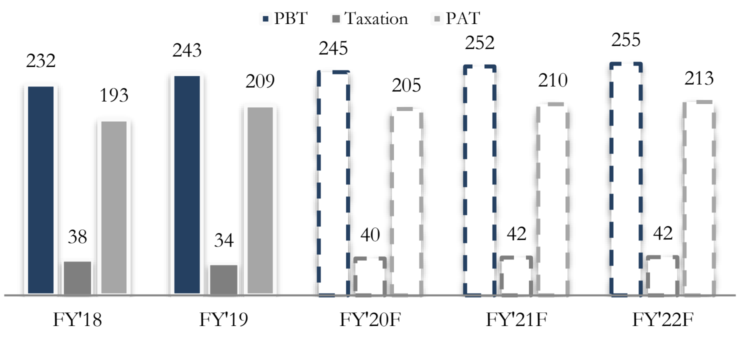
Fig. 9: PBT, Taxation and PAT – FY'18 - FY'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

With Solid and high quality capital position, the bank proposes final dividend of ₦2.80 per share: The balance sheet of the bank remains strong and solid in the full year of 2019. This is evident in the strong 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 15% for capital adequacy ratio. The liquidity ratio was 57.3% while capital adequacy ratio was 25.00% in 2019. In line with the new regulatory minimum requirement of 65.00% loan-to-deposit ratio given by the Central Bank of Nigeria to all the commercial banks in Nigeria, the bank increased its loan-to-deposit ratio to 68.60% in FY'19 (vs. 68.10% in FY'18).

Impressively, the bank proposed a final dividend of ₦2.50 per share (2018 Final dividend: ₦2.50) 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: ₦2.80) …

Mainly as a result of higher loans and advances and higher due from other banks, total assets increased by 6.57% to ₦6.35 trillion in FY'19 (vs. ₦5.96 trillion in FY'18). However, total liabilities increased by 5.16% to ₦5.40 trillion (vs. ₦5.14 trillion in 2018) due to higher deposits from customers. Consequently, net asset increased by 15.46% to ₦941.89 billion in FY'19 (vs. ₦815.75 billion in FY'18) and this translated to a net asset per share of ₦30.00 (FY'18: ₦25.98). Impressively, the bank proposed a final dividend of ₦2.50 per share (2018 Final dividend: ₦2.50) 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: ₦2.80).

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

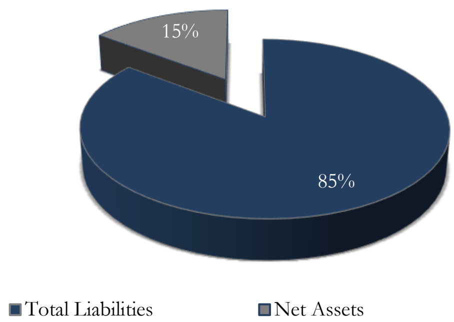
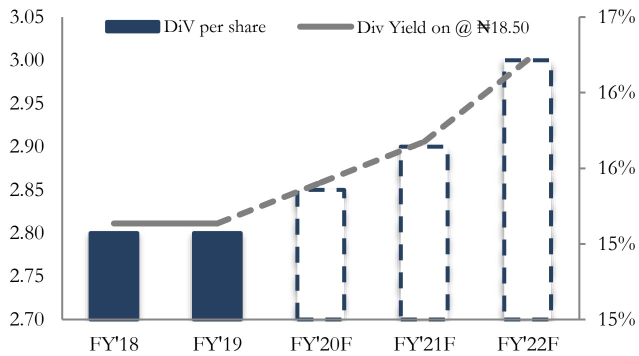


Fig. 11: Dividend Per Share and Dividend Yield (FY'18-FY'22F)



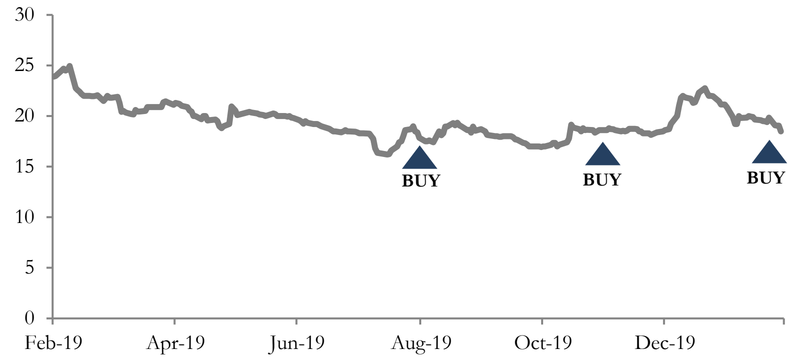
Source: Company's Presentation, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦25.48, representing an increase of 37.71% from the current price of ₦18.50. 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 N25.48, representing an increase of 37.71% from the current price of N18.50.

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	630,344	662,251	672,185	685,628
Change		5.06%	1.50%	2.00%
Interest and Similar Income	440,052	415,563	433,559	445,658
Change		-5.57%	4.33%	2.79%
Interest and Similar Expenses	-144,458	-148,532	-139,814	-142,611
Change		2.82%	-5.87%	2.00%
Net Interest Income	295,594	267,031	293,745	303,048
Change		-9.66%	10.00%	3.17%
Impairment Charge for credit losses	-18,372	-24,032	-26,887	-27,425
Change		30.81%	11.88%	2.00%
Fees and Commission Income	81,814	100,106	104,189	106,272
Change		22.36%	4.08%	2.00%
Trade gains	80,202	117,798	94,106	92,560
Change		46.88%	-20.11%	-1.64%
Personnel expenses	-68,556	-77,858	-82,007	-83,647
Change		13.57%	5.33%	2.00%
Profit Before Taxation	231,685	243,294	245,347	251,626
Change		5.01%	0.84%	2.56%
Taxation	-38,261	-34,451	-40,482	-41,518
Change		-9.96%	17.51%	2.56%
Profit After Taxation	193,424	208,843	204,865	210,107
Change		7.97%	-1.90%	2.56%

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

	2018	2019	2020F	2021F
Cash and balances	954,416	936,278	954,502	973,592
Treasury bills	1,000,560	991,393	994,833	1,014,730
Assets pledged as collateral	592,935	431,728	436,920	445,658
Due from other banks	674,274	707,103	719,238	733,622
Derivative assets	88,826	92,722	97,467	99,416
Loans and advances	1,823,111	2,305,565	2,554,302	2,605,388
Investment securities	565,312	591,097	600,261	612,266
Deffered tax assets	9,513	11,885	11,885	12,099
Other assets	80,948	77,395	77,395	84,023
Property and equipment	149,137	185,216	185,216	194,934
Total Assets	5,955,710	6,346,879	6,665,384	6,798,692
Customer deposits	3,690,295	4,262,289	4,436,419	4,525,148
Derivative Liabilities	16,995	14,762	15,124	15,427
Other liabilities	231,716	363,764	362,980	370,239
On lending facilities	393,295	392,871	403,311	411,377
Borrowings	437,260	322,479	322,649	329,102
Debt securities issued	361,177	39,092	53,775	54,850
Total Liabilities	5,139,959	5,404,993	5,604,408	5,716,496
Net Assets	815,751	941,886	1,060,976	1,082,196
Total equity and liabilities	5,955,710	6,346,879	6,665,384	6,798,692

Fig. 17: Profitability Ratio

	2018	2019	2020F	2021F
Return on Equity	23.71%	22.17%	19.31%	19.41%
Return on Assets	3.25%	3.29%	3.07%	3.09%
Net int. income to Rev.	46.89%	40.32%	43.70%	44.20%
PBT margin	36.76%	36.74%	36.50%	36.70%
Net Profit Margin	30.69%	31.54%	30.48%	30.64%
ROCE	5.36%	5.45%	5.40%	5.43%

Fig. 18: Asset Utilisation

	2018	2019	2020F	2021F
Cash/Revenue	151.41%	141.38%	142.00%	142.00%
Revenue to total assets (x)	10.58%	10.43%	10.08%	10.08%
Interest Inc. / Total Assets	7.39%	6.55%	6.50%	6.56%
Other Income/ Total Assets	0.30%	0.22%	0.28%	0.28%
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. 19: Liquidity Ratios

	2018	2019	2020F	2021F
Current ratio	1.16	1.17	1.19	1.19
Cash ratio	0.19	0.17	0.17	0.17
Interest Coverage ratio	1.60	1.64	1.75	1.76
Liquid Assets/Total Deposit	0.68	0.59	0.57	0.57
Loans & Adv./Total Deposit	0.49	0.54	0.58	0.58
Liquid Assets/Total Assets	0.42	0.40	0.38	0.38
Debt/net income	4.13	1.73	1.84	1.83
Debt to asset	0.13	0.06	0.06	0.06
Debt to equity	0.98	0.38	0.35	0.35
Total Liabilities / Total Asset	0.86	0.85	0.84	0.84
Cost to income ratio	0.49	0.49	0.49	0.49
net interest margin AVERAGED	0.08	0.08	0.07	0.05
Total liabilities/equities	6.30	5.74	5.28	5.28

Fig. 20: Shareholders' Investment Ratios

	2018	2019	2020F	2021F
Earnings per share	6.15	6.65	6.53	6.69
DiV per share	2.80	2.80	2.85	2.90
NAVPS	25.98	30.00	33.79	34.47
Earnings yield	32.42%	35.01%	34.34%	35.22%

Fig. 21: Capital Adequacy Ratios

	2018	2019	2020F	2021F
Loans and Advances/Equity	2.23	2.45	2.41	2.41
Equity/Total Assets	0.14	0.15	0.16	0.16
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

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