Zenith Bank Plc

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Nigeria | Equities | Financial Services | March 10, 2022 — PAC RESEARCH

Outstanding Performance as Zenith Bank Posts Net Profit of ₦244.6 Billion in FY-2021

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Price:	
- Current	**₦26.50**
- Target	**₦31.49**
Recommendation:	**BUY**

** As at Wednesday March 9, 2022*

INVESTMENT SUMMARY

The recently released full year 2021 audited report by the Zenith Bank showed impressive top-line as gross earnings grew by 9.92% to ₦765.56 billion (vs. ₦696.45 billion in the full year of 2020), driven by the remarkable performance across the major income lines of the bank. Despite the lower yields on interest earning assets during the period, the total interest income of the bank increased by 1.61% to ₦427.60 billion in FY'21 (vs. ₦420.81 billion in FY'20), driven by the expansion in loan books. In addition, the non-interest income improved significantly by 22.76% to ₦309.04 billion in FY'21 (vs. ₦251.75 billion in FY'20) as the bank recorded impressive growth in fees and commission income and trading income during the period. Impressively, the bank benefited from the lower interest rates (which reflected on cost of funds of 1.5% in FY'21 (FY'20: 2.1%)) as interest & similar expense fell by 11.84% to ₦106.79 billion during the period (vs. ₦121.13 billion in FY'20). In line with our expectation, the impairment loss on financial and non-financial instruments rose significantly by 51.60% to ₦59.93 billion in FY'21 (vs. ₦39.53 billion in FY'20), due to significant growth in loan books.

Despite the notable growth in impairment charge during the period, the profit before tax grew by 9.58% to ₦280.37 billion in FY'21 (vs. ₦255.86 billion in FY'20). The bank made higher provision of ₦35.82 billion for tax in FY'21 (FY'20: ₦25.30 billion). Albeit the higher tax provision, profit after tax grew by 6.07% to ₦244.56 billion in FY'21 (vs. ₦230.57 billion in FY'20), translating to EPS of ₦7.78 (FY'20: ₦7.30). The bank rewarded the shareholders with final dividend of ₦2.80 per share (2020 Final dividend: ₦2.70) after the payment of ₦0.30 as interim dividend per share in 2021 (2020 interim dividend: ₦0.30), totalling ₦3.10 in FY'21 (FY'20: ₦3.00). Based on the recent figures released by the bank, we maintain a **BUY** rating on the stock at the current price of ₦26.50 as present forward estimate places the company share price at ₦31.49 (Previous TP: ₦30.29).

Table. 1: Quarterly results highlights

	4Q2021	3Q2021	4Q2020	Q/q Δ	Y/y Δ
Gross Earnings (₦'mn)	246,885	173,114	187,475	+42.61%	+31.69%
Net Int. Income (₦'mn)	86,058	74,806	74,503	+15.04%	+15.51%
Net profit (₦'mn)	83,964	54,475	71,250	+54.13%	+17.84%

Source: NGX, Bloomberg, PAC Research

Table. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+5.37%/+21.84%
52-week range	₦27.50 - ₦19.50
30-day Average vol.	16,483,025
Shares Outstanding ('mn)	31,396.49
Market Cap. (₦bn)	841.43
EPS (₦)	7.78
DPS (₦) - FY2021	3.10

Source: NGX, Bloomberg, PAC Research

Table. 3: Key ratios

	FY'21	FY'20
Net Interest Margin	6.70%	7.90%
Net profit margin	31.95%	33.11%
Equity multiplier	7.38	7.59
Cash/ total Assets	15.75%	18.77%

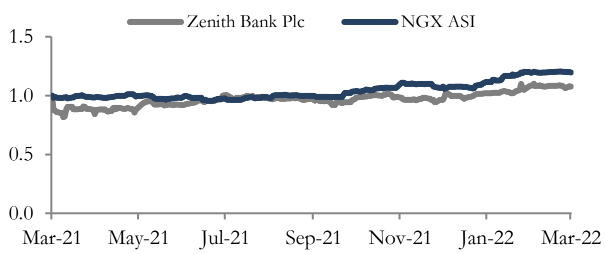
Source: NGX, PAC Research

Tab 4: Valuations

	FY2020	FY2021	FY2022F	FY2023F
P/E (x)	3.61	3.40	3.35	3.07
P/B (x)	0.74	0.65	0.61	0.57
Div Yield	11.32%	11.70%	12.08%	12.45%
Payout Ratio	40.85%	39.80%	40.48%	38.27%
EV/Revenue	1.80	1.31	1.43	1.38
Rev per share	22.18	24.38	25.60	26.88
ROE	20.63%	19.11%	18.10%	18.63%
ROA	2.72%	2.59%	2.48%	2.55%

Source: NGX, PAC Research

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



Source: Bloomberg, PAC Research

Gross earnings grow by 9.92% year-on-year, driven by higher interest-income and non-interest income: In line with our expectation, the gross earnings of the bank increased by 9.92% to ₦765.56 billion in the full year of 2021 (vs. ₦696.45 billion recorded in the full year of 2020), driven by improvement recorded in the two major income lines of the bank – interest income and non-interest income. The total interest income of the bank improved by 1.61% to ₦427.60 billion in FY'21 (vs. ₦420.81 billion reported in FY'20). The growth in the interest income of the bank was driven by the expansion in loan books, which resulted in higher interest income from loans and advances during the period. In addition, the non-interest income of the bank increased significantly by 22.76% to ₦309.04 billion in FY'21 (vs. ₦251.75 billion in FY'20), driven by impressive growth recorded in almost all the lines of income during the period.

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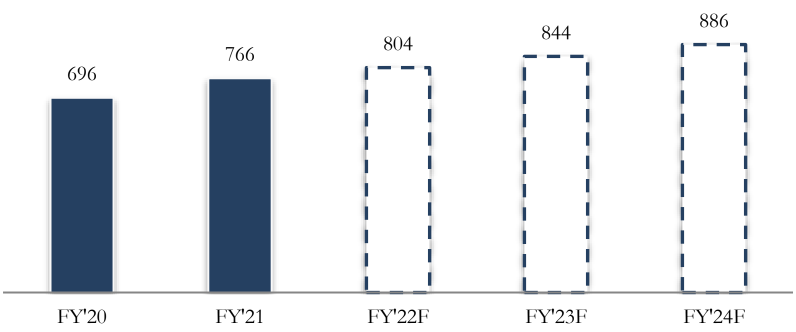
We may continue to see improvement in the gross earnings of the bank in coming quarters due to the expectation of impressive growth in non-interest income (especially from the electronic products, account maintenance fee, among others), and moderate growth in the interest income (especially from growth in loan books).

Fig. 2: Grosss Earnings – FY'20 – FY'24F (Billion NGN)



Source: NGX, PAC Research

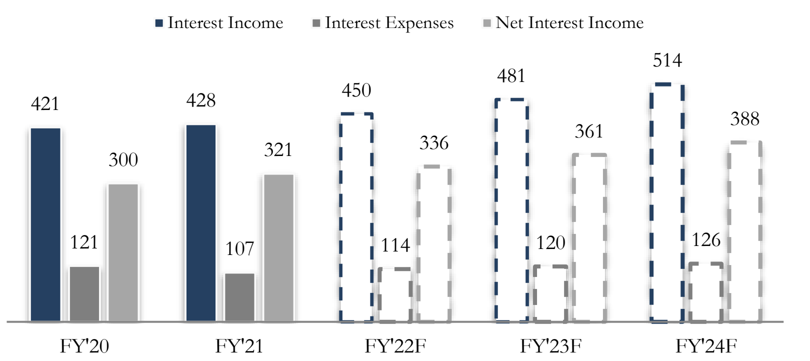
Interest income rises by 1.61% year-on-year, driven mainly by the growth in loan books: Having reported setback in total interest income in the first three quarters of 2021, the bank reported a growth of 16.43% in the fourth quarter of 2021. The significant growth recorded in the fourth quarter eliminated the setback recorded in the first three quarters of 2021. As a result, the total interest income improved slightly by 1.61% to ₦427.60 billion in FY'21 (vs. ₦420.81 billion in FY'20). The slight increase recorded in the total interest income during the period could be mainly attributed to the growth recorded in loan books, despite the lower interest rate and lower loan-to-deposit ratio of 62.6% (FY'20: 64.5%), which is below the regulatory minimum requirement of 65%. It is worthy to state that the total loans and advances improved by 20.75% to ₦3.36 trillion in FY'21 (vs. ₦2.78 trillion in FY'20).

Specifically, interest income from loans and advances to customers improved by 16.51% to ₦292.22 billion in FY'21 (vs. ₦250.81 billion in FY'20). In addition, the bank may have also gained from the long position taken in fixed income securities when yields were high as total interest income from the government and other bonds increased by 6.36% to ₦86.67 billion in FY'21 (vs. ₦81.51 billion in FY'20). However, the lower yields during the period reflected on the interest income from treasury bills which declined by 24.85% to ₦40.43 billion in FY'21 (vs. ₦53.80 billion reported in FY'20).

… total interest and similar expenses on current and savings accounts declined by 51.81% and 24.75% to ₦14.29 billion (FY'20: ₦29.66 billion) and ₦16.65 billion…

Impressively, the total interest expenses of the bank fell by 11.84% to ₦106.79 billion in the full year of 2021 (vs. ₦121.13 billion in the full year of 2020), owing to the improvement in the cost of funds occasioned by the lower interest rate during the period. The cost of funds fell to 1.50% in FY'21, from 2.10% reported in FY'20. Precisely, the total interest and similar expenses on current and savings accounts declined by 51.81% and 24.75% to ₦14.29 billion (FY'20: ₦29.66 billion) and ₦16.65 billion (FY'20: ₦22.13 billion) in FY'21 respectively. With the assumption of slight increase in interest rate, we may likely see slight increase in cost of funds in 2022 and this is expected to lift total interest and similar expenses in 2022.

Fig. 3: Interest Income and Interest Expenses: FY'20 – FY'24F (Billion NGN)



Source: NGX, PAC Research,

Non-interest income accelerates by 22.76% year-on-year, driven by notable growth across almost all the lines of income: In the full year of 2021, the total non-interest income of the bank grew by 22.76% to ₦309.04 billion (vs. ₦251.75 billion in the full year of 2020). In line with our projection, the significant improvement recorded in non-interest income could be ascribed to the growth recorded in income from fees on electronic products, account maintenance fee, credit related fees, trading income, among others. With the increased awareness in online banking, the income from fees on electronic products rose by 38.38% to ₦37.47 billion in FY'21 (vs. ₦27.08 billion in FY'20). In addition, the income from account maintenance fee and credit related fees grew by 42.76% and 29.76% to ₦31.39 billion (FY'20: ₦21.99 billion) and ₦18.05 billion (FY'20: ₦13.91 billion) in FY'21 respectively.

Also, the total trading gain of the bank improved significantly by 37.64% to ₦167.48 billion in FY'21 (vs. ₦121.68 billion in FY'20) mainly driven by ₦42.60 billion net gain on derivatives instruments during the period.

However, the total operating expenses of the bank rose by 13.08% to ₦289.53 billion in FY'21 (vs. ₦256.03 billion in FY'20), mainly because of inflationary pressures, exchange rate movement and increased regulatory cost during the period. Specifically, expenses on information & technology, AMCON Premium, NDIC Premium increased by 40%, 23% and 20% to ₦28.72 billion, ₦37.92 billion and ₦17.27 billion respectively in FY'21. Impressively, the 13.08% increase in total operating expenses in 2021 is 255 bps lower than the inflation rate of 15.63% for the month of December 2021. This reflected the effort of the management in maintaining cost-minimization strategy.

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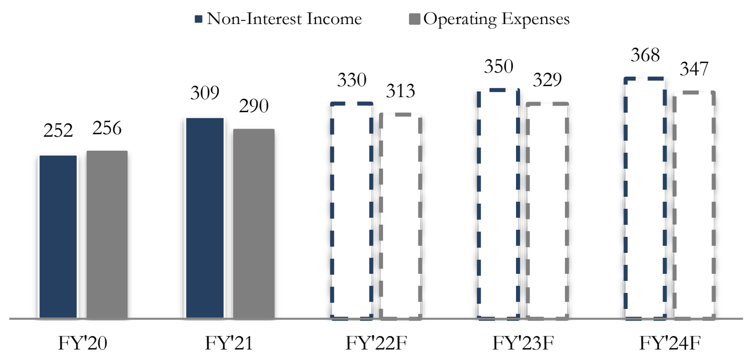
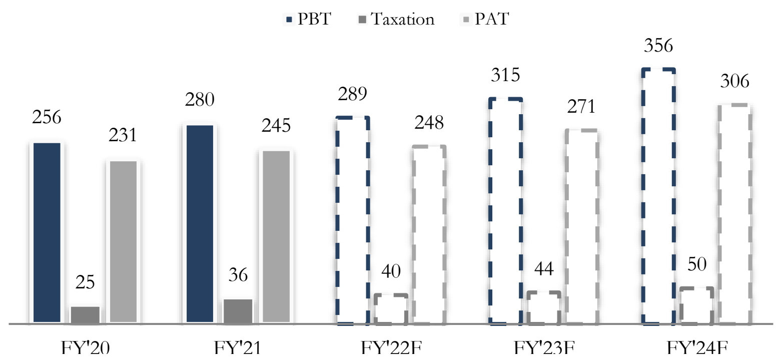
Fig. 4: Non-Int. Income & Total Op. Expense: FY'20 - FY'24F (Billion NGN)



Source: NGX, PAC Research

With impressive performance across the major income lines and lower cost of funds, PBT rises by 9.58% year-on-year: The impairment charge of Zenith Bank grew significantly by 51.60% to ₦59.93 billion in the full year of 2021 (vs. ₦39.53 billion in the full year of 2020), driven by the expansion in loan book, which led to higher expected credit losses on loans and advances during the period. However, the impressive performance of the bank across board offsets the higher impairment charge during the period as profit before tax improved by 9.58% to ₦280.37 billion in FY'21 (vs. ₦255.86 billion reported in FY'20). The bank made higher provision of ₦35.82 billion for tax in FY'21 (FY'20: ₦25.30 billion) mainly because of higher deferred tax expenses (origination of temporary differences) during the period. Despite the higher tax provision during the period, profit after tax grew by 6.07% to ₦244.56 billion in FY'21 (vs. ₦230.57 billion in FY'20) and this resulted in earning per share (EPS) of ₦7.78 in FY'21 (FY'20: ₦7.34). With the expectation of impressive performance from almost all the income lines going forward, we may likely see improvement in the bottom-line of the bank in coming quarters.

Fig. 5: PBT, Taxation and PAT – FY'20 - FY'24F (Billion NGN)



Source: NGX, PAC Research

Balance sheet remains solid and strong as Zenith proposes a final dividend of ₦2.80 per share: In the full year of 2021, the financial position of the bank remained strong and solid, which reflected on the key ratios and important figures in the balance sheet of the company. Liquidity and Capital Adequacy Ratio (CAR) of the bank, which stood at 61.9% (2020: 62.5%) and 21.0% (2020: 23.0%) in 2021 respectively, are well above the regulatory minimum requirements of 30% (for liquidity ratio) and 16% (for capital adequacy ratio). In addition, the non-performing loan ratio of the bank improved to 4.2% in 2021 (2020: 4.3%) and this is below the regulatory maximum requirement of 5.0%. However, the loan-to-deposit ratio of the bank declined to 62.6% in 2021 (2020: 64.5%) as the bank continued to monitor its loans closely. Specifically, 34.18% of the non-performing loans is attributed to Oil and Gas Sector, followed by General Commerce (22.75%) and Communication (22.03%). **(fig. 6)**

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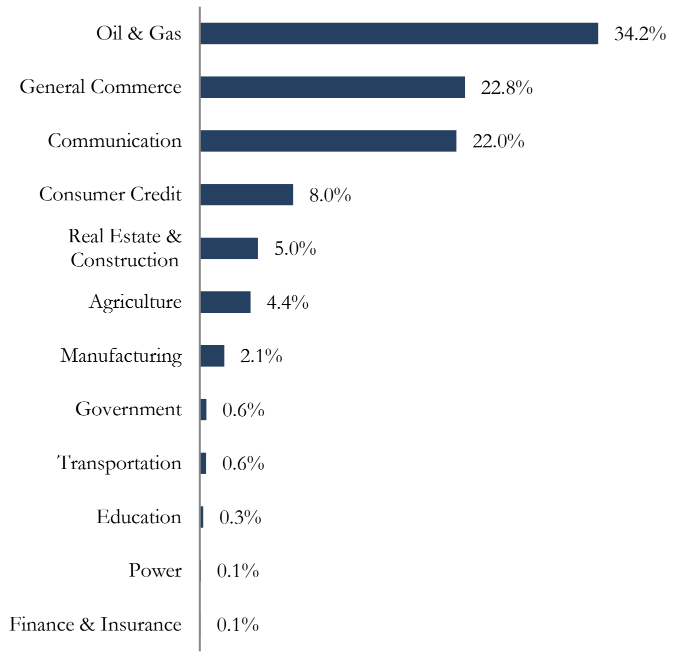
Fig. 6: Non-Performing Loans by Sector - FY'21



Source: Company's Presentation, PAC Research

Impressively, the total assets of the bank increased by 11.40% to ₦9.45 trillion in FY'21 (vs. ₦8.48 trillion in FY'20), mainly because of significant growth in total loans & advances and treasury bills during the period. The total loans and advances grew by 20.75% to ₦3.36 trillion (FY'20: ₦2.78 trillion) while treasury bills increased by 11.86% to ₦1.76 trillion in FY'21 (FY'20: ₦1.58 trillion). Upstream Oil & Gas Sector accounted for 18.3% of the total loans, followed by Government (14.5%), General Commerce (13.7%) and Other Manufacturing Sector (11.0%) **(Fig. 7).**

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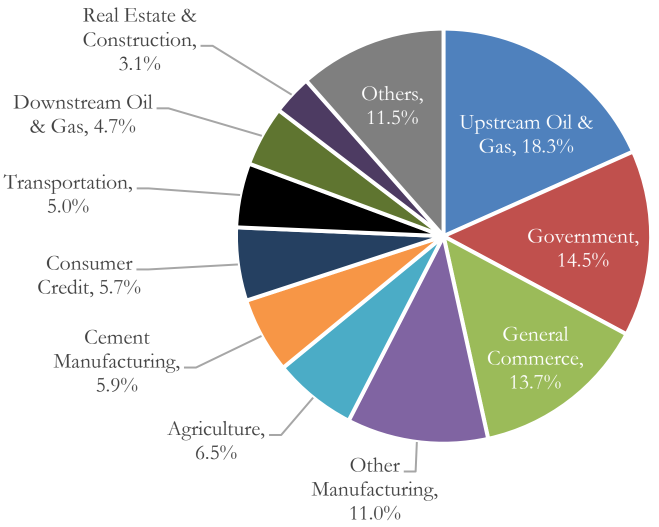
Fig. 7: Loans by Sector - FY'21

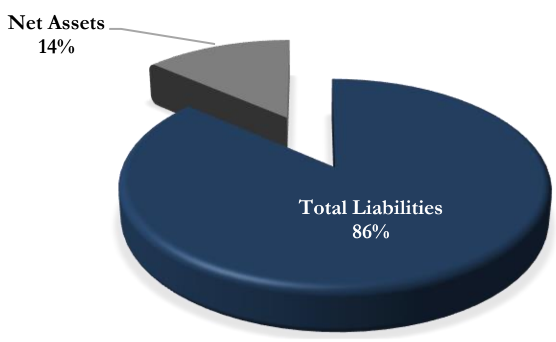


Source: Company's Presentation, PAC Research

However, the total liabilities of the bank increased by 10.92% to ₦8.17 trillion in FY'21 (vs. ₦7.36 trillion in FY'20), mainly due to higher deposits from customers, which increased by 21.20% to ₦6.47 trillion in FY'21 (FY'20: ₦5.34 trillion). The growth in the total assets outweighed the increase recorded in the total liabilities during the period. Consequently, the net assets improved by 14.51% to ₦1.28 trillion in FY'21 (vs. ₦1.12 trillion in FY'20), and this resulted in a net asset per share of ₦40.76 (FY'20: ₦35.59). With the expectation of improved performance from the major income lines of the business, we will continue to see a robust balance in the coming quarters.

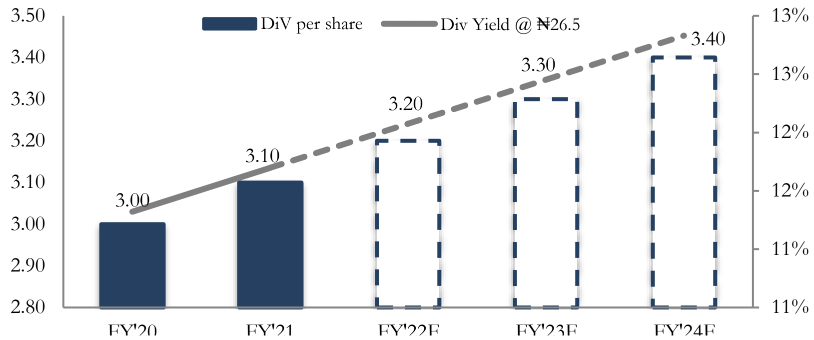
Impressively, the bank proposed a final dividend of ₦2.80 per share in 2021 (2020 Final dividend: ₦2.70) after the payment of ₦0.30 as interim dividend per share in 2021 (2020 interim dividend: ₦0.30), totalling ₦3.10 in FY'21 (FY'20: ₦3.00). This is expected to improve in 2022 as we anticipate progressive bottom-line.

Fig. 8: Total Liabilities Vs Net Asset in FY'21



Source: NGX, PAC Research

Fig. 9: Dividend Per Share and Dividend Yield (FY'20-FY'24F)



Source: NGX, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦31.49 representing an increase of 18.82% from the current price of ₦26.50. In arriving at the target price, we employed Dividend Discount Model and residual income valuation. 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.

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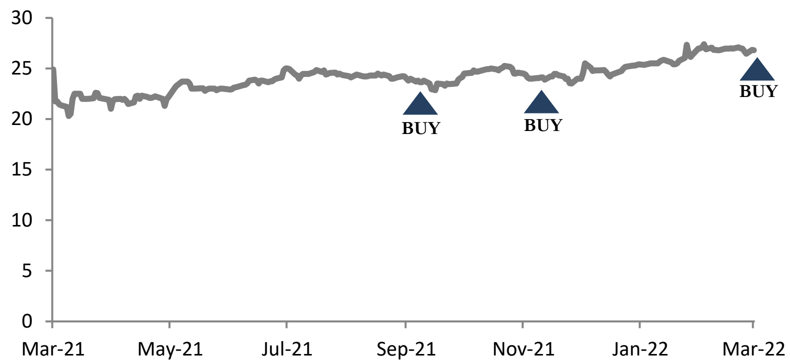
Fig. 10: Share Price History (Naira)



Source: NGX, PAC Research

Fig. 11: Statement of Profit or Loss, N'mn

	2020	2021	2022F	2023F
Gross Earnings	696,450	765,558	803,836	844,028
Change	5.16%	9.92%	5.00%	5.00%
Interest and Similar Income	420,813	427,597	450,148	481,096
Change	1.26%	1.61%	5.27%	6.87%
Interest and Similar Expenses	-121,131	-106,793	-114,145	-119,852
Change	-18.45%	-11.84%	6.88%	5.00%
Net Interest Income	299,682	320,804	336,003	361,244
Change	12.23%	7.05%	4.74%	7.51%
Impairment Charge for credit losses	-39,534	-59,932	-64,307	-67,522
Change	64.51%	51.60%	7.30%	5.00%
Fees and Commission Income	79,332	103,958	120,575	126,604
Change	-20.75%	31.04%	15.98%	5.00%
Trade gains	121,678	167,483	168,806	177,246
Change	3.29%	37.64%	0.79%	5.00%
Personnel expenses	-79,520	-79,885	-84,403	-88,623
Change	2.13%	0.46%	5.66%	5.00%
Profit Before Taxation	255,861	280,374	288,577	314,822
Change	5.17%	9.58%	2.93%	9.09%
Taxation	-25,296	-35,816	-40,401	-44,075
Change	-26.57%	41.59%	12.80%	9.09%
Profit After Taxation	230,565	244,558	248,176	270,747
Change	10.40%	6.07%	1.48%	9.09%

Fig. 12: Statement of Financial Position, N'mn

	2020	2021	2022F	2023F
Cash and balances	1,591,768	1,488,363	1,502,207	1,592,33
Treasury bills	1,577,875	1,764,945	1,902,796	2,016,96
Assets pledged as collateral	298,530	392,594	400,589	424,62
Due from other banks	810,494	691,244	701,030	743,09
Derivative assets	44,496	56,187	77,113	81,74
Loans and advances	2,779,027	3,355,728	3,708,448	3,930,95
Investment securities	996,916	1,303,726	1,301,913	1,380,02
Deffered tax assets	5,786	12,013	11,860	13,85
Other assets	169,967	140,941	77,395	197,82
Property and equipment	190,170	176,182	185,216	186,76
Total Assets	8,481,272	9,447,843	10,014,714	10,615,59
Customer deposits	5,339,911	6,472,054	6,810,005	7,218,60
Derivative Liabilities	11,076	14,674	13,079	13,86
Other liabilities	703,292	487,432	550,809	583,85
On lending facilities	384,573	369,241	454,105	481,35
Borrowings	870,080	750,469	751,104	796,17
Debt securities issued	43,177	45,799	50,984	54,04
Total Liabilities	7,363,800	8,168,181	8,643,889	9,162,52
Net Assets	1,117,472	1,279,662	1,370,825	1,453,07
Total equity and liabilities	8,481,272	9,447,843	10,014,714	10,615,59

Fig. 13: Profitability Ratio

	2020	2021	2022F	2023F
Return on Equity	20.63%	19.11%	18.10%	18.63%
Return on Assets	2.72%	2.59%	2.48%	2.55%
Net int. income to Rev.	43.03%	41.90%	41.80%	42.80%
PBT margin	36.74%	36.62%	35.90%	37.30%
Net Profit Margin	33.11%	31.95%	30.87%	32.08%
ROCE	4.10%	4.07%	3.97%	4.08%

Fig. 14: Asset Utilisation

	2020	2021	2022F	2023F
Cash/Revenue	228.55%	194.42%	186.88%	188.66%
Revenue to total assets (x)	8.21%	8.10%	8.03%	7.95%
Interest Inc. / Total Assets	4.96%	4.53%	4.49%	4.53%
Other Income/ Total Assets	0.60%	0.40%	0.40%	0.44%
Rev. to total fixed assets	366.22%	382.76%	357.97%	354.59%
fixed asset turnover	27.31%	26.13%	27.94%	28.20%

Fig. 15: Liquidity Ratios

	2020	2021	2022F	2023F
Current ratio	1.15	1.16	1.16	1.16
Cash ratio	0.22	0.18	0.17	0.17
Interest Coverage ratio	2.11	2.63	2.53	2.63
Liquid Assets/Total Deposit	0.78	0.70	0.69	0.69
Loans & Adv./Total Deposit	0.52	0.52	0.54	0.54
Liquid Assets/Total Assets	0.49	0.48	0.47	0.47
Debt/net income	3.96	3.26	3.23	3.14
Debt to asset	0.11	0.08	0.08	0.08
Debt to equity	0.82	0.62	0.59	0.59
Total Liabilities / Total Asset	0.87	0.86	0.86	0.86
Cost to income ratio	0.50	0.51	0.52	0.51
net interest margin AVERAGED	0.08	0.07	0.07	0.07
Total liabilities/equities	6.59	6.38	6.31	6.31

Fig. 16: Shareholders' Investment Ratios

	2020	2021	2022F	2023F
Earnings per share	7.34	7.79	7.90	8.62
DiV per share	3.00	3.10	3.20	3.30
NAVPS	35.59	40.76	43.66	46.28
Earnings yield	27.40%	29.06%	29.49%	32.18%

Fig. 17: Capital Adequacy Ratios

	2020	2021	2022F	2023F
Loans and Advances/Equity	2.49	2.62	2.71	2.71
Equity/Total Assets	0.13	0.14	0.14	0.14
Loan Loss Expense/ Equity	0.04	0.05	0.05	0.05

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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