Zenith Bank Plc

PAC Research
| Ideas | Partnerships | Solutions |

Nigeria | Equities | Financial Services | August 28, 2019 — PAC RESEARCH

Impressive Performance as Non-Interest Income Drives Earnings

Oluwole Adeyeye
oluwole.adeyeye@panafricancapitalholdings.com

Price:

- Current	**₦18.50**
- Target	**₦31.75**
Recommendation:	**STRONG BUY**

** As at Wednesday August 28, 2019*

INVESTMENT SUMMARY

Zenith Bank is notable for impressive financial results in the Nigerian banking industry and the audited report for the first half of 2019 is no exception as gross earnings increased modestly by 2.91% to ₦331.59 billion (vs. ₦322.20 billion in the first half of 2018) due to higher non-interest income. During the period, non-interest income increased by 23.86% to ₦109.73 billion (vs. ₦88.60 billion recorded in H1'18), mainly as a result of significant improvement in fees on electronic products and higher credit related fees. However, interest income declined by 6.15% to ₦214.60 billion in H1'19 (vs. ₦228.67 billion in H1'18), due to decline in the yield on money market instruments and drop in average interest rate on loans and advances. The bank's effort towards cost optimisation yielded positive results, as interest expenses dropped by 3.51% to ₦72.09 billion in the first half of 2019 (vs. ₦74.71 billion in the first half of 2018). In addition, operating expenses increased marginally by 1.08% to ₦126.83 billion in H1'19 (vs. ₦125.48 billion in H1'18). Due to higher expected credit losses on loans and advances, impairment charge rose by 41.31% to ₦13.74 billion in H1'19 (vs. ₦9.72 billion in H1'18).

With impressive non-interest income, profit before tax rose by 4.02% to ₦111.68 billion in H1'19 (vs. ₦107.36 billion in H1'18). The bank made a lower provision of ₦22.80 billion for income tax (vs. ₦25.62 billion in H1'18) and as a result, profit after tax rose by 8.74% to ₦88.88 billion in H1'19 (vs. ₦81.74 billion in H1'18). Impressively, 12-month trailing EPS rose by 8.80% to ₦6.39, from ₦5.87 recorded in the previous period. As a result, the bank rewarded the shareholders with interim dividend of ₦0.30 per share which shall be paid on September 2, 2019. 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 ₦31.75 (Previous target price: ₦32.29).

Fig. 1: Quarterly results highlights

	2Q2019	1Q2019	2Q2018	Q/q Δ	Y/y Δ
Gross Earnings (₦'mn)	173,475	158,111	148,073	+9.72%	+17.16%
Net Int. Income (₦'mn)	56,378	86,137	83,969	-34.55%	-32.86%
Net profit (₦'mn)	38,648	50,234	34,658	-23.06%	+11.51%

Source: NSE, Bloomberg, PAC Research

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-19.74%/-15.91%
52-week range	₦26.85 - ₦16.00
30-day Average vol.	20,609,980
Shares Outstanding ('mn)	31,396.49
Market Cap. (₦bn)	580.84
EPS (₦) - 12months trailing	6.39
DPS (₦) - FY2018	2.80

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	H1'19	H1'18
Net Interest Margin	8.60%	10.10%
Net profit margin	26.81%	25.37%
Equity multiplier	7.20	7.31
Cash/ total Assets	13.04%	16.05%

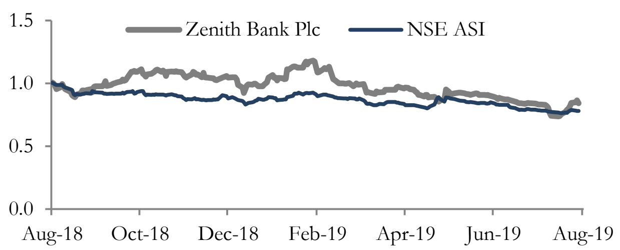
Source: NSE, Bloomberg, PAC Research

Fig. 4: Valuations

	FY2017	FY2018	FY2019F	FY2020F
P/E (x)	3.26	3.30	2.90	2.62
P/B (x)	0.72	0.71	0.71	0.66
Div Yield	14.59%	15.14%	15.68%	16.22%
Payout Ratio	47.64%	45.45%	45.42%	42.56%
EV/Revenue	1.26	1.67	1.711	1.66
Rev per share	23.73	20.08	19.79	20.97
ROE	21.91%	23.71%	24.35%	25.26%
ROA	3.18%	3.25%	3.39%	3.53%

Source: NSE, Bloomberg, PAC Research

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

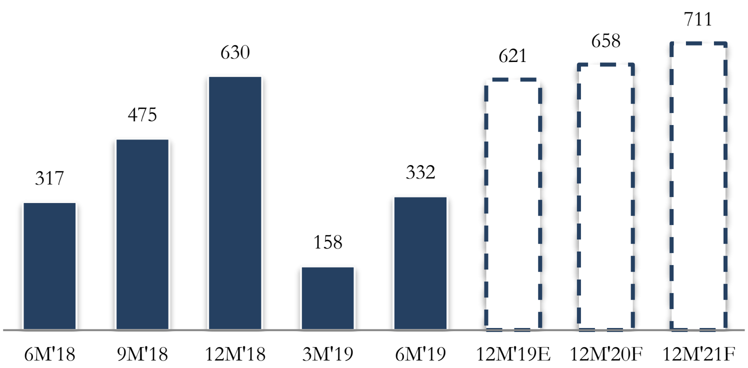


Source: Bloomberg, PAC Research

Gross earnings rises by 2.91%, due to higher non-interest income: In the six-month to June 2019, Zenith Bank Plc reported improved figure for top-line as gross earnings increased by 2.91% to ₦331.59 billion (vs ₦322.20 billion in the six-month to June 2018). The increase in gross earnings can be mainly attributed to higher non-interest income during the period. The bank's non-interest income increased significantly by 23.86% to ₦109.73 billion in H1'19 (vs. ₦88.60 billion in H1'18), due to substantial improvement in trading gains, increased income from account maintenance charges, higher fees on electronic products and higher credit related fees. However, the bank reported an unimpressive figure for interest & similar income as it declined by 6.15% to ₦214.60 billion in first half of 2019 (vs. ₦228.67 billion reported in the first half of 2018). The drop in average interest rate on loans and advances to customers and fall in the yields on money market instruments contributed to the decline in interest and similar income in the first half of 2019.

The increase in gross earnings can be mainly attributed to higher non-interest income during the period

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



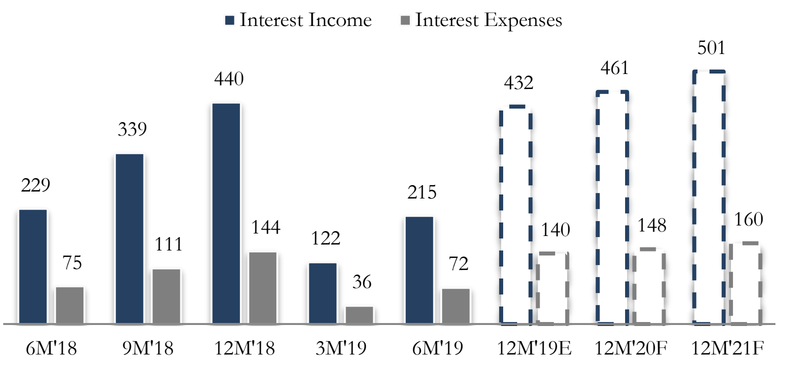
Source: NSE, Bloomberg, PAC Research

Interest income declined by 6.15% YoY as a result of lower yields on interest bearing assets: In the six-month to June 2019, Zenith Bank reported a setback in the interest income generated from loans and advances to customers and this mirrored on total interest income as it declined by 6.15% to ₦214.60 billion in H1'19 (vs. ₦228.67 billion in H1'18). Interest income from loans and advances to customers declined significantly by 21.44% to ₦115.04 billion (vs. ₦146.43 billion in H1'18), due to drop in average interest rate during the period. However, the bank reported impressive figures for interest income from treasury bills, promissory note, government & other bonds and placement with banks & discount houses during the period under review. Interest income from treasury bills increased by 3.16% to ₦53.04 billion (vs. ₦51.41 billion in H1'18) while interest income from government & other bonds increased by 27.31% to ₦32.95 billion in H1'19 (vs. ₦25.88 billion in H1'18). In addition, interest income from placement with banks and discount houses improved significantly by 138.22% to ₦11.78 billion in H1'19 (vs. ₦4.94 billion in H1'18).

… the bank reported impressive figures for interest income from treasury bills, promissory note, government & other bonds and placement with banks &discount houses …

During the period under review, interest expenses fell by 3.51% to ₦72.09 billion (vs. ₦74.71 billion in H1'18), which reflected the bank's effort towards cost of funds optimisation as it declined to 3.00% (H1'19: 3.40%). Interest and similar expenses on current account, time deposits account and borrowed funds & lease declined by 4.40%, 7.52% and 6.27% to ₦5.52 billion (H1'18: ₦5.78 billion), ₦21.09 billion (H1'18: ₦22.80 billion), ₦34.52 billion in H1'19 (H1'18: ₦36.83 billion) respectively. However, the bank recorded higher interest expenses on current accounts as it rose by 17.77% to ₦10.95 billion in H1'19 (vs. ₦9.30 billion in H1'18).

Fig. 7: Interest Income and Interest Expenses: 6M'18-12M'21F (Billion NGN)



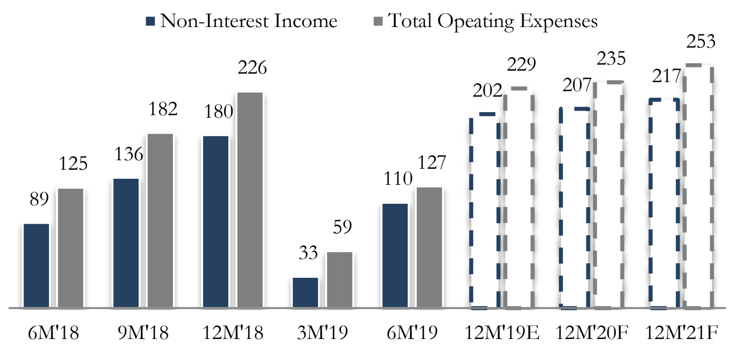
Source: NSE, Bloomberg, PAC Research,

Non-interest income rises by 23.86% due to significant growth in fees on electronic products: With significant improvement in total fee and commission income in the first half of 2019, total non-interest income of the bank increased by 23.86% to ₦109.73 billion (vs. ₦88.60 billion reported in the first half of 2018). Mainly as a result of 168.69% growth in fees on electronic products and 44.45% growth in credit related fees, total fee and commission income increased by 35.03% to ₦63.07 billion (vs. ₦46.71 billion in H1'18). In addition, higher trading gains also contributed to the improved non-interest income as it increased by 22.53% to ₦45.10 billion (vs. ₦36.81 billion in H1'18), due to lower loss on derivatives.

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%...

There is an improvement in the bank's effort towards cost optimisation as operating expenses increased marginally by 1.08% to ₦126.83 billion in the first half of 2019, from ₦125.48 billion reported in the first half of 2018. The slight increase in operating expenses can be attributed to higher personnel expenses and higher depreciation of property and equipment during the period. Personnel expenses and depreciation of property & equipment increased by 11.25% and 22.89% to ₦38.73 billion (H1'18: ₦34.81 billion) and ₦9.79 billion (H1'18: ₦7.97 billion) in H1'19 respectively. Consequently, cost-to-income ratio improved to 53.20% in the first half of 2019 (vs. 53.90% reported in first half of 2018).

Fig. 8: Non-Int. Income & Total Op. Expense: 6M’18-12M’21F (Billion NGN)

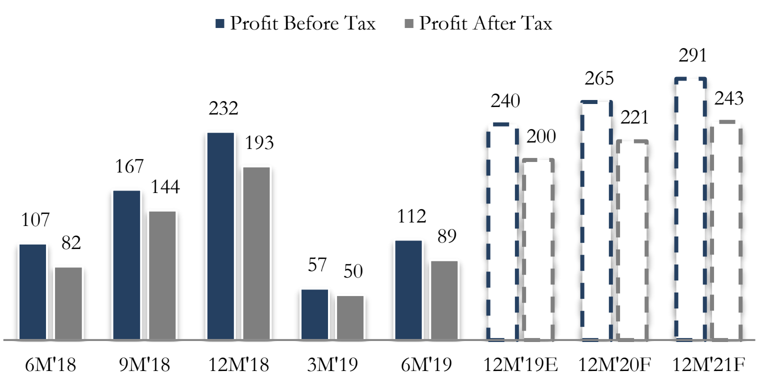


Source: NSE, Company’s Results, PAC Research

Growth in non-interest income drives 4.02% increase in PBT: In addition to lower interest income achieved during the period, the bank reported an unimpressive figure for impairment charges as it rose by 41.31% to ₦13.74 billion (vs. ₦9.72 billion in corresponding period of the previous year), due to higher expected credit losses on loans and advances. 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 4.02% to ₦111.68 billion in H1’19 (vs. ₦107.36 billion reported in H1’18). The bank made a provision of ₦22.80 billion for tax during the period (H1’19: ₦25.62 billion) and as a result, profit after tax increased by 8.74% to ₦88.88 billion in H1’19 (vs. ₦81.74 billion in H1’18). Impressively, 12-month trailing EPS improved by 8.80% to ₦6.39, from ₦5.87 recorded in the previous period. As a result, the bank rewarded the shareholders with interim dividend of ₦0.30 per share which shall be paid on September 2, 2019.

…the benefit derived from lower cost of funds and higher non-interest income offset the lower interest income and higher impairment charge…

Fig. 9: Profit before Tax and Profit after Tax – 6M’18-12M’21F (Billion NGN)



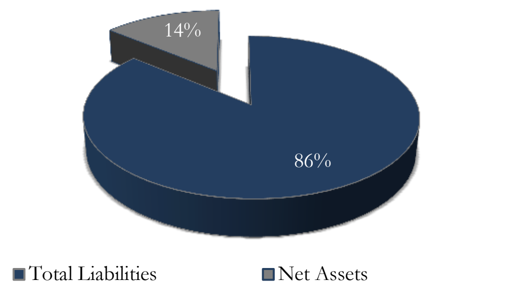
Source: NSE, Bloomberg, PAC Research

… Zenith Bank maintain a loan-to-deposit ratio of 62.70% in H1'19 (vs. 53.5% in H1'18).

Balance sheet remains strong and solid; Zenith Bank rewards shareholders with interim dividends of ₦0.30 per share: The balance sheet of the bank remains strong and solid in the first half of 2018. This is evident in 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 15% for capital adequacy ratio. The liquidity ratio remained at 74.60% (H1'18: 77.70%) while capital adequacy ratio improved to 25.00% (H1'18: 21.00%). In line with the new regulatory minimum requirement of 60.00% loan-to-deposit ratio given by the Central Bank of Nigeria to all the commercial banks in Nigeria(effective September 1, 2019), Zenith Bank maintain a loan-to-deposit ratio of 62.70% in H1'19 (vs. 53.5% in H1'18). However, non-performing loan ratio increased to 5.30% in H1'19 (H1'18: 4.90%).

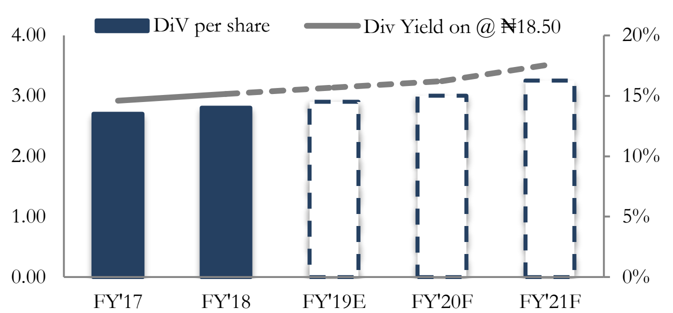
As a result of higher securities portfolio and interbank placements, total assets increased by 12.22% to ₦5.90 trillion in H1'19 (vs. ₦5.26 trillion in H1'18). However, total liabilities increased by 11.95% to ₦5.08 trillion (vs. ₦4.54 trillion in the corresponding period of previous year) due to higher customers deposits. Consequently, net asset increased by 13.90% to ₦819.51 billion (vs. ₦719.51 billion in H1'18) and this translated to a net asset per share of ₦26.10 (H1'18: ₦22.92). In line with our expectation, the bank rewarded the shareholders with interim dividend payment of ₦0.30 per share in H1'19 (H1'18: ₦0.30).

Fig. 10: Total Liabilities Vs Net Asset in H1'19



Source: Company's Presentation, PAC Research

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



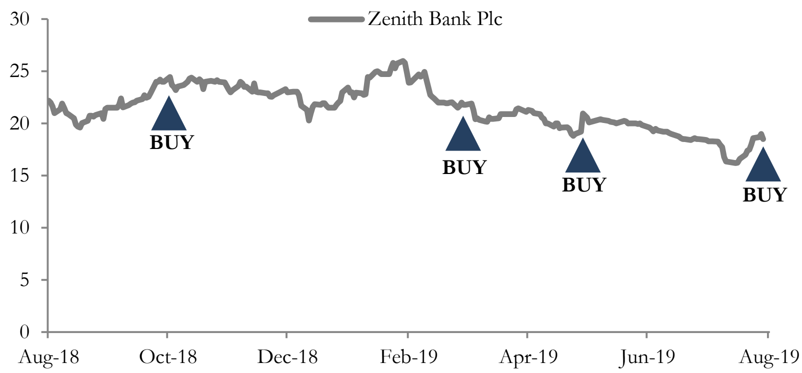
Source: Company's Presentation, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦31.75, representing an increase of 71.63% from the current price of ₦18.50. 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 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 banking industry, and outlook from the management.

Our valuation puts the target price of the stock at N31.75, representing an increase of 71.63% 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

	2017	2018	2019E	2020F
Gross Earnings	745,189	630,344	621,204	658,476
Change		-15.41%	-1.45%	6.00%
Interest and Similar Income	474,628	440,052	431,737	460,933
Change		-7.28%	-1.89%	6.76%
Interest and Similar Expenses	-216,637	-144,458	-140,082	-148,486
Change		-33.32%	-3.03%	6.00%
Net Interest Income	257,991	295,594	291,655	312,447
Change		14.58%	-1.33%	7.13%
Impairment Charge for credit losses	-98,227	-18,372	-24,848	-19,754
Change		-81.30%	35.25%	-20.50%
Fees and Commission Income	90,143	81,814	99,393	105,356
Change		-9.24%	21.49%	6.00%
Trade gains	157,974	80,202	86,969	85,602
Change		-49.23%	8.44%	-1.57%
Personnel expenses	-64,459	-68,556	-75,787	-79,017
Change		6.36%	10.55%	4.26%
Profit Before Taxation	203,461	231,685	240,095	265,037
Change		13.87%	3.63%	10.39%
Taxation	-25,528	-38,261	-39,616	-43,731
Change		49.88%	3.54%	10.39%
Profit After Taxation	177,933	193,424	200,480	221,306
Change		8.71%	3.65%	10.39%

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

	2017	2018	2019E	2020F
Cash and balances	957,663	954,416	948,889	1,005,822
Treasury bills	936,817	1,000,560	1,024,987	1,086,486
Assets pledged as collateral	468,010	592,935	496,963	559,705
Due from other banks	495,803	674,274	658,476	697,985
Derivative assets	57,219	88,826	93,181	98,771
Loans and advances	2,100,362	1,823,111	1,894,672	1,975,429
Investment securities	330,951	565,312	528,023	559,705
Deffered tax assets	9,561	9,513	11,182	11,853
Other assets	92,494	80,948	84,484	89,553
Property and equipment	133,384	149,137	158,407	171,204
Total Assets	5,595,253	5,955,710	5,914,794	6,272,974
Customer deposits	3,437,915	3,690,295	3,634,043	3,852,086
Derivative Liabilities	20,805	16,995	17,394	18,437
Other liabilities	243,023	231,716	232,952	246,929
On lending facilities	383,034	393,295	386,948	410,165
Borrowings	356,496	437,260	422,419	447,764
Debt securities issued	332,931	361,177	388,253	411,548
Total Liabilities	4,783,137	5,139,959	5,091,388	5,396,871
Net Assets	812,116	815,751	823,406	876,103
Total equity and liabilities	5,595,253	5,955,710	5,914,794	6,272,974

Fig. 17: Profitability Ratio

	2017	2018	2019E	2020F
Return on Equity	21.91%	23.71%	24.35%	25.26%
Return on Assets	3.18%	3.25%	3.39%	3.53%
Net int. income to Rev.	34.62%	46.89%	46.95%	47.45%
PBT margin	27.30%	36.76%	38.65%	40.25%
Net Profit Margin	23.88%	30.69%	32.27%	33.61%
ROCE	5.12%	5.36%	5.63%	5.86%

Fig. 18: Asset Utilisation

	2017	2018	2019E	2020F
Cash/Revenue	128.51%	151.41%	152.75%	152.75%
Revenue to total assets (x)	13.32%	10.58%	10.50%	10.50%
Interest Inc. / Total Assets	8.48%	7.39%	7.30%	7.35%
Other Income/ Total Assets	0.40%	0.30%	0.26%	0.26%
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	0.19	0.19
Interest Coverage ratio	0.94	1.60	1.71	1.78
Liquid Assets/Total Deposit	0.65	0.68	0.69	0.69
Loans & Adv./Total Deposit	0.61	0.49	0.52	0.51
Liquid Assets/Total Assets	0.40	0.42	0.42	0.42
Debt/net income	3.87	4.13	4.04	3.88
Debt to asset	0.12	0.13	0.14	0.14
Debt to equity	0.85	0.98	0.98	0.98
Total Liabilities / Total Asset	0.85	0.86	0.86	0.86
Cost to income ratio	0.53	0.49	0.49	0.47
net interest margin AVERAGED	0.08	0.08	0.08	0.07
Total liabilities/equities	5.89	6.30	6.18	6.16

Fig. 20: Shareholders' Investment Ratios

	2017	2018	2019E	2020F
Earnings per share	5.67	6.16	6.39	7.05
DiV per share	2.70	2.80	2.90	3.00
NAVPS	25.87	25.98	26.23	27.90
Earnings yield	30.63%	33.30%	34.52%	38.10%

Fig. 21: Capital Adequacy Ratios

	2017	2018	2019F	2020F
Loans and Advances/Equity	2.59	2.23	2.30	2.25
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

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 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 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 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 nor any of its directors, officers or employees has verified the contents hereof and accordingly, none of the analysts, PanAfrican Capital 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, reports prepared by PanAfrican Capital 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 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, 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. As with other employees of PanAfrican Capital, analysts' compensation is impacted by the overall profitability of PanAfrican Capital, which includes revenues from all business areas of PanAfrican Capital.

PanAfrican Capital Holdings Ltd
8A, Elsie Femi Pearse Street
Victoria Island
Lagos, Nigeria
Tel: +234 (1) 2716899, 2718630
www.panafricancapitalholdings.com