Zenith Bank Plc

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Zenith Bank Delivers Impressive Results Despite the COVID-19 Challenges

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Price:	
- Current	₦16.40
- Target	₦27.05
Recommendation:	STRONG BUY

** As at Wednesday Sept. 9, 2020*

INVESTMENT SUMMARY

The lockdown of economic activities and restriction of movement in various States in Nigeria, as a result of coronavirus pandemic, did not have adverse effect on the performance of Zenith Bank in the first half of 2020 as gross earnings increased by 4.37% to ₦346.09 billion (vs. ₦331.59 billion in the first half of 2019). The increase in the gross earnings of the bank can be mainly attributed to the improvement in the non-interest income lines during the period. Due to higher foreign currency revaluation gain and treasury bills trading income, non-interest income rose by 6.16% to ₦116.49 billion in H1’20 (vs. ₦109.73 billion in H1’19). In addition, the interest income line of the bank improved by 1.10% to ₦216.95 billion in H1’20 (vs. ₦214.60 billion in H1’19), as a result of improved interest income from loans and advances to customers. Impressively, the bank benefited from the lower rates, which reflected on cost of funds of 2.2% in H1’20 (H1’19: 3.0%), as interest & similar expense fell by 17.40% to ₦59.54 billion (vs. ₦72.09 billion in H1’19). The higher LDR continue to show on the bank’s loan impairment as it increased significantly by 74.18% to ₦23.92 billion in H1’20 (vs. ₦13.74 billion in H1’19).

With the impressive non-interest income and interest income, profit before tax rose by 2.19% to ₦114.12 billion in H1’20 (vs. ₦111.68 billion in H1’19). The bank made a lower provision of ₦10.30 billion for income tax in H1’20 (vs. ₦22.80 billion in H1’19) and as a result, profit after tax rose by 16.81% to ₦103.83 billion in H1’20 (vs. ₦88.88 billion in H1’19). Impressively, 12-month trailing EPS rose by 11.58% to ₦7.13, from ₦6.39 recorded in the previous period. As a result, the bank rewarded the shareholders with interim dividend of ₦0.30 per share in H1’20 (H1’19: ₦0.30). Based on the recently released figures, we maintain a BUY rating on the stock at the current price of ₦16.40 as present forward estimate places the company share price at ₦27.05 (Previous target price: ₦25.67).

Fig. 1: Quarterly results highlights

	2Q2020	1Q2020	2Q2019	Q/q Δ	Y/y Δ
Gross Earnings (₦’mn)	179,274	166,814	173,475	+7.47%	+3.34%
Net Int. Income (₦’mn)	75,908	81,501	56,378	-6.86%	+34.64%
Net profit (₦’mn)	53,300	50,526	38,648	+17.37%	+53.44%

Source: NSE, Bloomberg, PAC Research

Fig. 2: Stock data

FYE	December
Price Mov’t: YtD / 52wk	-11.83%/-5.57%
52-week range	₦23.00 - ₦10.70
30-day Average vol.	21,164,970
Shares Outstanding ('mn)	31,396.49
Market Cap. (₦bn)	514.90
EPS (₦) – 12 Months Trailing	7.13
DPS (₦) - FY2019	2.80

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	H1'20	H1'19
Net Interest Margin	9.00%	8.60%
Net profit margin	30.00%	26.81%
Equity multiplier	7.66	7.20
Cash/ total Assets	22.51%	13.04%

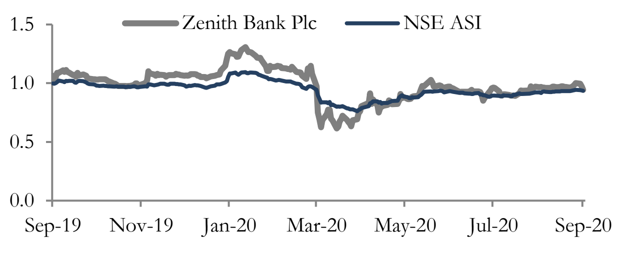
Source: NSE, Bloomberg, PAC Research

Fig. 4: Valuations

	FY2018	FY2019	FY2020E	FY2021F
P/E (x)	2.66	2.47	2.53	2.40
P/B (x)	0.63	0.55	0.52	0.55
Div Yield	17.07%	17.07%	17.07%	17.68%
Payout Ratio	45.45%	42.09%	43.19%	41.02%
EV/Revenue	1.56	1.05	0.86	1.09
Rev per share	20.08	21.09	21.73	22.49
ROE	23.71%	22.17%	21.75%	23.03%
ROA	3.25%	3.29%	2.66%	2.76%

Source: NSE, Bloomberg, PAC Research

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

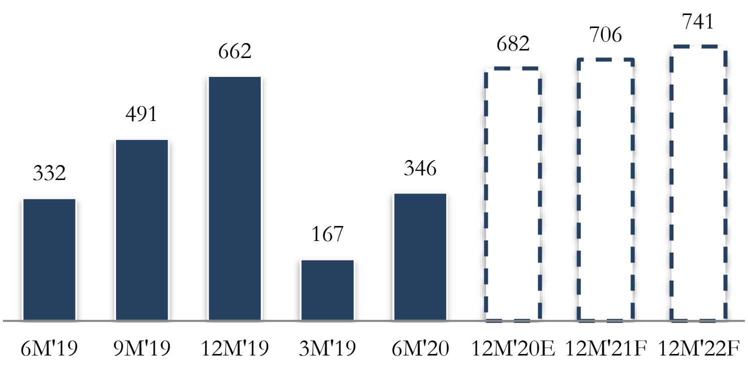


Source: Bloomberg, PAC Research

Gross earnings rises by 4.37% due to higher interest income and non-interest income: Despite the lockdown of economic activities and restriction of movement occasioned by the widespread of coronavirus in the country, especially in the second quarter of 2020, Zenith Bank reported an impressive performance in the first half of 2020 as gross earnings improved by 4.37% to ₦346.09 billion (vs ₦331.59 billion in the first half of 2019). The increase in the gross earnings of the bank in the first half 2020 was attributed to improved performance from the interest income lines and non-interest income lines. The bank's interest income improved marginally by 1.10% to ₦216.95 billion (vs. ₦214.60 billion in H1'19) while non-interest income rose by 6.16% to ₦116.49 billion in H1'20 (vs. ₦109.73 billion in H1'19). The rise in interest income can be mainly ascribed to the significant improvement in interest income from loans and advances to customers while the growth achieved in the non-interest income line was attributed to higher foreign currency revaluation gain and improved treasury bills trading income during the period under review.

Despite the lockdown of economic activities and restriction of movement occasioned by the widespread of coronavirus in the country, especially in the second quarter of 2020, Zenith Bank reported an impressive performance…

Fig. 6: Grosss Earnings – 6M'19 –12M'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

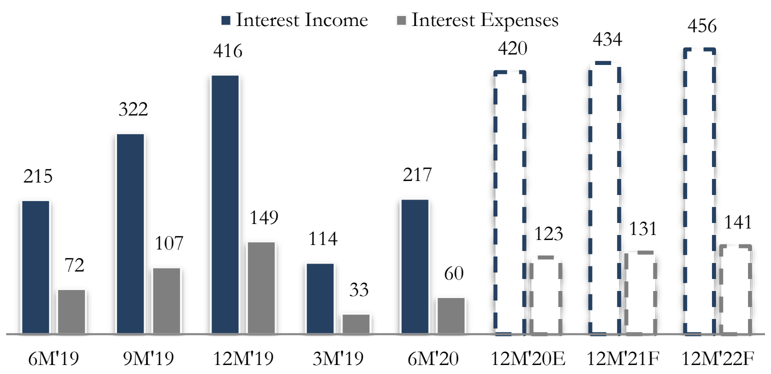
Total interest income rises by 1.10% year-on-year as a result of higher interest income from loans and advances: Zenith bank benefited from the higher loan-to-deposit ratio of 65%, which was introduced by the Central Bank of Nigeria in the third quarter of last year, as interest income from loans and advances to customers improved during the period. Despite the lower yield environment during the period, interest income from loans and advances increased by 11.58% to ₦128.38 billion in H1'20 (vs. ₦115.04 billion in H1'19). In addition, interest income from government & other bonds increased by 19.94% to ₦39.52 billion in H1'20 (vs. ₦32.95 billion in H1'19) as the bank continue to enjoy long term position taken in the bond market when rates were high. Also, interest income from placement with banks and discount houses improved by 41.44% to ₦16.65 billion in H1'20 (vs. ₦11.77 billion in H1'19).

Despite the lower yield environment during the period, interest income from loans and advances increased by 11.58% to ₦128.38 billion in H1'20 …

However, the bank's interest income from treasury bills fell significantly by 46.49% to ₦28.38 billion in H1'20 (vs. ₦53.04 billion in H1'19) due to the lower yield in the money market and contraction in T-bills portfolio during the period. The improvement in interest income from loans and advances to customers, government & other bonds and placement with banks and discount houses outweighed the drop in interest income from the treasury bills in the first half of 2020. Consequently, total interest income rose by 1.10% to ₦216.95 billion in H1'20 (vs. ₦214.60 billion in H1'19).

The bank benefited from the lower yield environment in the first half of 2020 as cost of funds fell by 80 bps to 2.2% (H1'19: 3.0%). This resulted to a drop of 17.40% in the interest & similar expenses as it declined to ₦59.54 billion (vs. ₦72.09 billion reported in H1'19). Specifically, interest expenses on current account fell by 9.31% while interest expenses on borrowed funds and lease fell by 50.75%. However, the interest expenses on savings accounts and time deposits rose by 15.23% and 18.14% respectively, as a result of higher deposits from the customers during the period.

Fig. 7: Interest Income and Interest Expenses: 6M'19-12M'22F (Billion NGN)



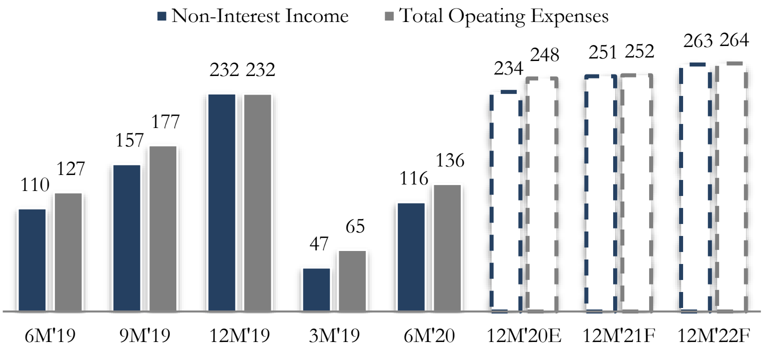
Source: NSE, Bloomberg, PAC Research,

Foreign currency revalution gain offesets the lower income from fee and commission as non-interest income rises by 6.16%: Zenith Bank did not feel the impact of lower bank charges, which was introduced by the Central Bank of Nigeria in the beginning of 2020 as total non-interest income improved by 6.16% to ₦116.49 billion in the first half of 2020 (vs. ₦109.73 billion in the first half of 2019). The improvement in the non-interest income of the bank was mainly attributed to significant improvement in foreign currency revaluation gain and treasury bills trading income. Mainly as result of drop in the value of Naira in the FX market, foreign currency revaluation gain increased significantly by 239.62% to ₦22.02 billion in H1'20 (vs. ₦6.48 billion in H1'19). In addition, treasury bills trading income rose by 18.90% to ₦65.70 billion in H1'20 (vs. ₦55.25 billion in H1'19).

The improvement in the non-interest income of the bank was mainly attributed to significant improvement in foreign currency revaluation gain and treasury bills trading income.

In line with our projection, net income on fee and commission fell by 39.97% to ₦33.50 billion in H1'20 (vs. 55.81 billion in H1'19), mainly as a result of lower income on fees on electronic products due to lower bank charges during the period.
However, the total operating expenses of the bank increased by 7.11% to ₦135.85 billion in H1'20 (vs. ₦126.83 billion in H1'19), due to higher depreciation of property and equipment, higher expenses on deposit insurance premium, information technology, fuel and maintenance, among others. Impressively, the 7.11% increase in total operating expenses in the first half of 2020 is 545 bps lower than the inflation rate of 12.56% for the month of June 2020.

Fig. 8: Non-Int. Income & Total Op. Expense: 6M'19-12M'22F (Billion NGN)

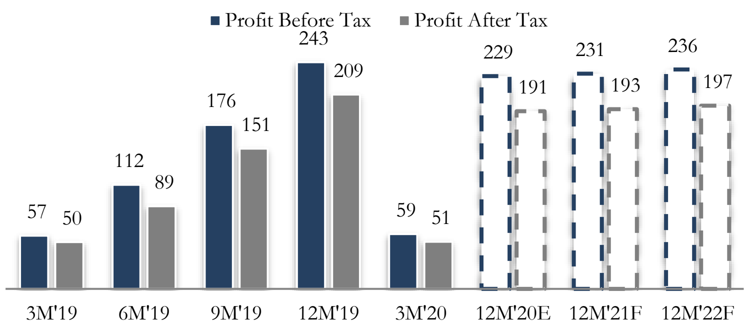


Source: NSE, Company's Results, PAC Research

Even with unimpressive figure for impairment charges, PBT increases by 2.19% year-on-year: In the first half of 2020, the bank reported an unimpressive figure for impairment charges as it increased significantly by 74.18% to ₦23.92 billion (vs. ₦13.74 billion in the first half of 2019), due to the 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 of 65.00%, which was introduced by the CBN in the third quarter of last year, to have adverse impact on the non-performing loans of the banks. However, the benefit derived from both the interest income and non-interest income lines outweighed the lower higher impairment charge during the period. As a result, profit before tax increased by 2.19% to ₦114.12 billion in H1'20 (vs. ₦111.68 billion reported in H1'19). However, due to zero provision for dividend tax during the period, the bank made a lower provision of ₦10.30 billion for taxation in the first half of 2020 (H1'19: ₦22.80 billion). As a result, profit after tax increased significantly by 16.81% to ₦103.83 billion in H1'20 (vs. ₦88.88 billion in H1'19) and this makes Zenith Bank Plc the best performing bank, in terms of profit after tax, in Nigeria in the first half of 2020.

…the benefit derived from both the interest income and non-interest income lines outweighed the lower higher impairment charge during the period. As a result, profit before tax increased by 2.19% to ₦114.12 billion...

Fig. 9: Profit before Tax and Profit after Tax – 6M'19-12M'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

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 2020. 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 of the bank remained at 43.8% (H1'19: 57.2%) while capital adequacy ratio was 20.00% in H1'20 (H1'19: 22.00%). 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, Zenith Bank maintained a loan-to-deposit ratio of 66.10% in H1'20 (vs. 68.6% in H1'19). However, non-performing loan ratio increased to 4.7% in H1'20 (H1'19: 4.30%).

Mainly as a result of improved loans and advances and higher cash & balances with central banks, total assets increased by 28.51% to ₦7.58 trillion in H1'20 (vs. ₦5.90 trillion in H1'19). However, total liabilities increased by 29.77% to ₦6.59 trillion (vs. ₦5.08 trillion in the corresponding period of previous year) due to higher customers deposits. Consequently, net asset increased by 20.68% to ₦988.98 billion (vs. ₦819.51 billion in H1'19) and this translated to a net asset per share of ₦31.50 in H1'20 (H1'19: ₦26.10). In line with our expectation, the bank rewarded the shareholders with interim dividend of ₦0.30 per share in H1'20 (H1'19: ₦0.30).

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Fig. 10: Total Liabilities Vs Net Asset - H1'20

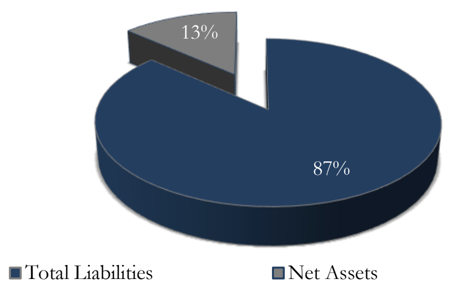
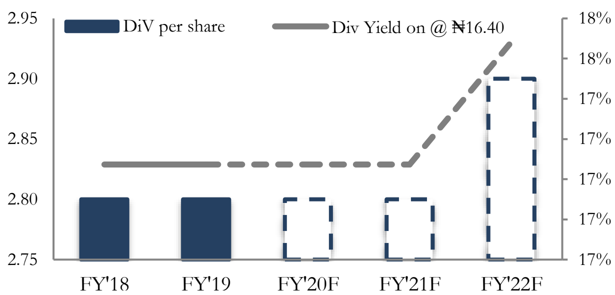


Fig. 11: Dividend Per Share and Dividend Yield (FY'18-FY'22F)



Source: NSE, Zenith Bank, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦27.05, representing an increase of 64.95% from the current price of ₦16.40. 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, especially in during this pandemic period, the regulatory environment and outlook from the management.

Our valuation puts the target price of the stock at N25.67, representing an increase of 61.98% from the current price of N15.85.

Fig. 12: Share Price History (Naira)

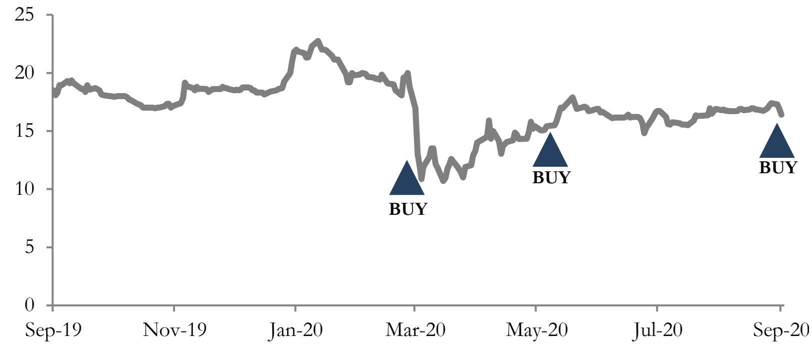


Fig. 13: Statement of Profit or Loss, N'mn

	2018	2019	2020E	2021F
Gross Earnings	630,344	662,251	682,119	705,993
Change		5.06%	3.00%	3.50%
Interest and Similar Income	440,052	415,563	419,503	434,185
Change		-5.57%	0.95%	3.50%
Interest and Similar Expenses	-144,458	-148,532	-122,781	- 130,609
Change		2.82%	-17.34%	6.38%
Net Interest Income	295,594	267,031	296,722	303,577
Change		-9.66%	11.12%	2.31%
Impairment Charge for credit losses	-18,372	-24,032	-44,338	-45,890
Change		30.81%	84.49%	3.50%
Net Fees and Comm. Income	81,814	100,106	66,848	84,719
Change		22.36%	-33.22%	26.73%
Trade gains	80,202	117,798	126,192	130,609
Change		46.88%	7.13%	3.50%
Personnel expenses	-68,556	-77,858	-77,079	-79,424
Change		13.57%	-1.00%	3.04%
Profit Before Taxation	231,685	243,294	238,059	256,628
Change		5.01%	-2.15%	7.80%
Taxation	-38,261	-34,451	-34,519	-42,344
Change		-9.96%	0.20%	22.67%
Profit After Taxation	193,424	208,843	203,541	214,285
Change		7.97%	-2.54%	5.28%

Fig. 14: Statement of Financial Position, N'mn

	2018	2019	2020E	2021F
Cash and balances	954,416	936,278	1,602,979	1,411,985
Treasury bills	1,000,560	991,393	886,754	974,270
Assets pledged as collateral	592,935	431,728	375,165	423,596
Due from other banks	674,274	707,103	886,754	882,491
Derivative assets	88,826	92,722	98,907	102,369
Loans and advances	1,823,111	2,305,565	2,830,792	2,965,169
Investment securities	565,312	591,097	609,132	630,451
Deffered tax assets	9,513	11,860	11,860	13,642
Other assets	80,948	77,395	77,395	136,424
Property and equipment	149,137	185,216	185,216	197,814
Total Assets	5,955,710	6,346,854	7,655,416	7,768,037
Customer deposits	3,690,295	4,262,289	4,945,359	5,118,447
Derivative Liabilities	16,995	14,762	40,927	42,360
Other liabilities	231,716	363,764	886,754	847,191
On lending facilities	393,295	392,871	409,271	423,596
Borrowings	437,260	322,479	327,417	338,876
Debt securities issued	361,177	39,092	54,569	56,479
Total Liabilities	5,139,959	5,404,968	6,674,598	6,837,610
Net Assets	815,751	941,886	980,818	930,428
Total equity and liabilities	5,955,710	6,346,854	7,655,416	7,768,037

Fig. 15: Profitability Ratio

	2018	2019	2020E	2021F
Return on Equity	23.71%	22.17%	20.75%	23.03%
Return on Assets	3.25%	3.29%	2.66%	2.76%
Net int. income to Rev.	46.89%	40.32%	43.50%	43.00%
PBT margin	36.76%	36.74%	34.90%	36.35%
Net Profit Margin	30.69%	31.54%	29.84%	30.35%
ROCE	5.36%	5.45%	4.18%	4.34%

Fig. 16: Asset Utilisation

	2018	2019	2020E	2021F
Cash/Revenue	151.41%	141.38%	235.00%	200.00%
Revenue to total assets (x)	10.58%	10.43%	8.91%	9.09%
Interest Inc. / Total Assets	7.39%	6.55%	5.48%	5.59%
Other Income/ Total Assets	0.30%	0.22%	0.53%	0.45%
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. 17: Liquidity Ratios

	2018	2019	2020E	2021F
Current ratio	1.16	1.17	1.15	1.14
Cash ratio	0.19	0.17	0.24	0.21
Interest Coverage ratio	1.60	1.64	1.94	1.96
Liquid Assets/Total Deposit	0.68	0.59	0.63	0.59
Loans & Adv./Total Deposit	0.49	0.54	0.57	0.58
Liquid Assets/Total Assets	0.42	0.40	0.40	0.39
Debt/net income	4.13	1.73	1.88	1.85
Debt to asset	0.13	0.06	0.05	0.05
Debt to equity	0.98	0.38	0.39	0.42
Total Liabilities / Total Asset	0.86	0.85	0.87	0.88
Cost to income ratio	0.49	0.49	0.51	0.50
net interest margin AVERAGED	0.08	0.08	0.07	0.05
Total liabilities/equities	6.30	5.74	6.81	7.35

Fig. 18: Shareholders' Investment Ratios

	2018	2019	2020E	2021F
Earnings per share	6.16	6.65	6.48	6.83
DiV per share	2.80	2.80	2.80	2.80
NAVPS	25.98	30.00	31.24	29.63
Earnings yield	37.57%	40.56%	39.53%	41.62%

Fig. 19: Capital Adequacy Ratios

	2018	2019	2020E	2021F
Loans and Advances/Equity	2.23	2.45	2.89	3.19
Equity/Total Assets	0.14	0.15	0.13	0.12
Loan Loss Expense/ Equity	0.02	0.03	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

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