

Strong Growth in Non-interest Income and Improved Interest Expense Lead to Higher Profitability

INVESTMENT SUMMARY

The audited report for the first half of 2021 released by Zenith Bank showed a slight setback in top-line as gross earnings fell by 0.15% to ₦345.56 billion (vs. ₦346.09 billion in first half of 2020). The reduction in the gross earning was mainly driven by the lower figures recorded in the interest income line of the bank during the period. The total interest income of the bank declined by 6.00% to ₦203.93 billion in H1'21 (vs. ₦216.95 billion reported in H1'20), due to the lower yields in fixed income market in the first half of 2021, which adversely impacted yields on marketable securities and the pricing of risk assets. However, the bank benefitted from its improved technology as non-interest income of the bank improved by 8.83% to ₦126.77 billion in H1'21 (vs. ₦116.49 billion in H1'20).

The bank profited from the lower yield environment in the first half of 2021, reflected on the lower cost of funds of 1.3% in H1'21 (H1'20: 2.2%). This resulted to a significant fall in total interest and similar expense which declined by 26.12% to ₦43.99 billion in the first half of 2021, from ₦59.54 billion reported in the first half of 2020. Impressively, Zenith Bank continue to watch its loans book as impairment charge fell by 17.24% to ₦19.80 billion in H1'21 (vs. ₦23.92 billion in H1'20).

With impressive non-interest income, significant fall in interest expense and lower impairment charges, profit before tax improved by 2.57% to ₦117.06 billion in H1'21 (vs. ₦114.12 billion in H1'20). The bank made a provision of ₦10.94 billion for tax in H1'21 (H1'20: ₦10.29 billion). Consequently, profit after tax grew by 2.21% to ₦106.12 billion (vs. ₦103.83 billion in H1'20) and this translated to a 12-month trailing EPS of ₦7.42. The bank rewarded the shareholders with interim dividend of ₦0.30 per share in H1'21 (H1'20: ₦0.30). Based on the recent figures released by the bank, we maintain a **BUY** rating on the stock at the current price of ₦24.10 as present forward estimate places the company share price at ₦30.82 (Previous TP: ₦30.78).

Table 1: Quarterly results highlights

	2Q2021	1Q2021	2Q2020	Q/q Δ	Y/y Δ
Gross Earnings (₦mn)	188,250	157,309	179,274	+19.67%	+5.01%
Net Int. Income (₦mn)	74,503	83,168	75,908	-10.42%	-1.85%
Net profit (₦mn)	53,059	53,060	53,300	0.00%	-0.45%

Source: NSE, Bloomberg, PAC Research

September 4, 2021

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Price:

- Current	₦24.10
- Target	₦30.82
Recommendation:	BUY

* As at Friday September 3, 2021

Table 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-3.02%/+42.73%
52-week range	₦28.50 - ₦16.05
30-day Average vol.	8,240,896
Shares Outstanding (mn)	31,396.49
Market Cap. (₦bn)	755.09
12-Month Trailing EPS (₦)	7.42
DPS (₦) - FY2020	3.00

Source: NSE, Bloomberg, PAC Research

Table 3: Key ratios

	H1'21	H1'20
Net Interest Margin	6.50%	9.00%
Net profit margin	30.71%	30.00%
Equity multiplier	7.45	7.66
Cash/ total Assets	16.73%	22.51%

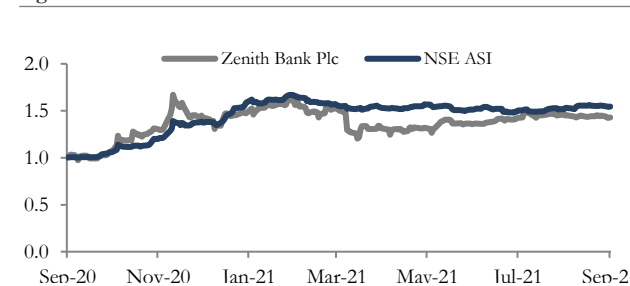
Source: NSE, Bloomberg, PAC Research

Table 4: Valuations

	FY2019	FY2020	FY2021F	FY2022F
P/E (x)	3.62	3.27	3.18	3.10
P/B (x)	0.80	0.68	0.64	0.57
Div Yield	11.64%	12.47%	12.47%	12.68%
Payout Ratio	42.09%	40.85%	39.73%	39.35%
EV/Revenue	1.41	1.67	1.34	1.34
Rev per share	21.09	22.18	22.40	23.19
ROE	22.17%	20.63%	20.07%	18.30%
ROA	3.29%	2.72%	2.59%	2.54%

Source: NSE, Bloomberg, PAC Research

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

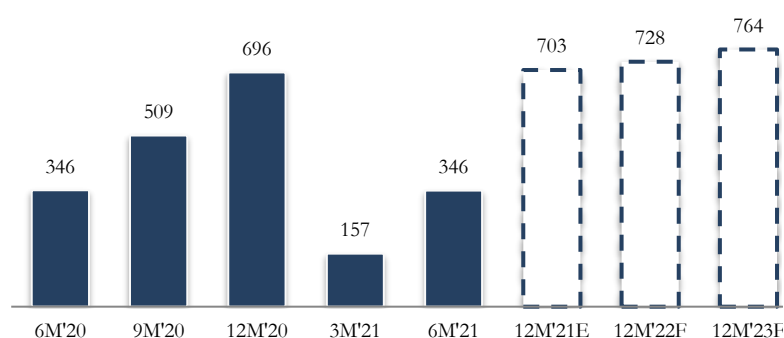


Source: Bloomberg, PAC Research

A marginal fall in gross earnings, driven by lower interest-income: Zenith Bank continued with a slight setback in the gross earnings (year-on-year) in the first half of 2021, though with positive growth when looking at the quarter-on-quarter performance (**table 1**). In the first half of 2021, the gross earnings fell marginally by 0.15% to ₦345.56 billion (vs ₦346.09 billion recorded in first half of 2020), driven by the setback recorded in the interest and similar income recorded during the period. The total interest income of the bank fell by 6.00% to ₦203.93 billion in H1'21, when compared with ₦216.95 billion interest income achieved in the corresponding period of previous year. However, the total non-interest income of the bank improved by 8.83% to ₦126.77 billion in H1'21 (vs. ₦116.49 billion in H1'20), mainly driven by about 35% increase in the total fee and commission income of the bank during the period.

In the second half 2021, we expect to see improvement in gross earnings of the bank due to the expectation of relatively high yield (when compared with the second half of previous year) in the country. The high yield is expected to have significant impact on the interest income line of the bank. In addition, the continuous improvement in on-line banking is expected to drive non-interest income line in the second half of 2021.

Fig. 2: Gross Earnings – 6M'20 – 12M'23F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

A fall in interest income was mitigated by higher interest expense as net interest income rises marginally by 1.61% year-on-year. As a result of lower yields in the country in the first half of 2021, when compared with the corresponding period of last year, the interest income line of Zenith Bank fell by 6.00% to ₦203.93 billion (vs. ₦216.95 billion in the first of 2020). Specifically, the decline in the interest income line of the bank can be attributed to a fall in interest income from treasury bills, promisory note and placement with banks and discount houses. Interest income from treasury bills declined significantly by 28.52% to ₦20.29 billion in H1'21 (vs. ₦28.38 billion in H1'20) while interest income from placement with banks and discount houses fell significantly by 65.99% to ₦5.66 billion in H1'21 (vs. ₦16.65 billion in H1'20).

In the second half 2021, we expect to see improvement in gross earnings of the bank due to the expectation of relatively high yield...

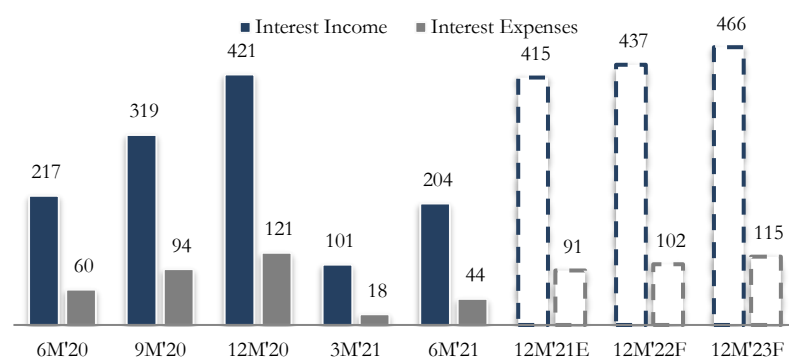
However, the bank overturned the setback recorded in interest income from loans and advances to customers in the first quarter of the year as it improved by 5.50% to ₦135.43 billion in H1'21 (vs. ₦128.37 billion in H1'20), driven by higher loans and advances during the period. In addition, the bank continues to benefit from the long position taken in the bonds market when yields were high as total interest income from the government and other bonds increased by 5.22% to ₦41.58 billion in H1'21 (vs. ₦39.52 billion in H1'20). We maintain that the relatively high yield in the market in the second half of 2021 (when compared to second half of last year) may drive up the total interest and similar income in the second half of 2021.

The lower yield environment in the first half of 2021 is not totally a drawback in the overall operation of the bank as cost of funds declined significantly to 1.3%, from 2.2% recorded in the corresponding period of previous year. The lower cost of funds resulted in reduction of 6.91%, 42.45% and 42.85% in interest and similar expense on current accounts, saving accounts and time deposits respectively, nevertheless the significant increase in total deposit during the period. As a result, the total interest and similar expenses fell significantly by 26.12% to ₦43.99 billion in H1'21 (vs. ₦59.55 billion in H1'20).

The success recorded in total interest expense of the bank may not be sustainable in the second half of 2021 due to relatively high cost of capital, when compared with lower yield achieved in second half of last year. The improved interest expense outweighed the setback recorded in interest income line of the bank as net interest income increased by 1.61% to ₦159.94 billion in H1'21 (vs. ₦157.41 billion in H1'20).

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Fig. 3: Interest Income and Interest Expenses: 6M'20 – 12M'23F (Billion NGN)



Source: NSE, Bloomberg, PAC Research.

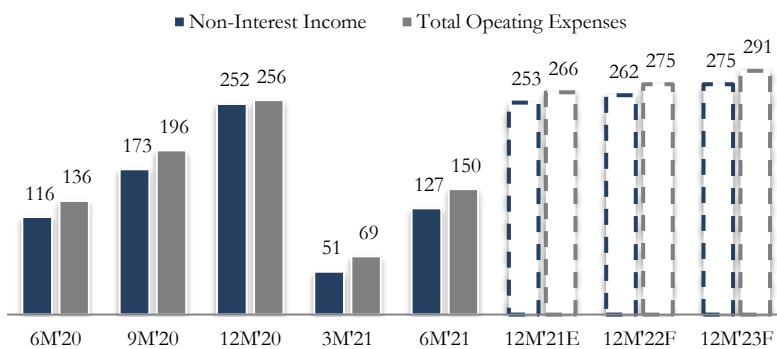
Non-interest income rises by 8.83% year-on-year, driven by higher income from fees on electronic products and account maintenance fee: Zenith bank continue to benefit from technology advancement in the first half of 2021 as significant improvement in income from fee and commission income drove non-interest income line of the bank which improved by 8.83% to ₦126.77 billion (vs. ₦116.49 billion in first half of 2020).

The fee & commission income increased by 35.47% to ₦62.52 billion in first half of 2021 (vs. ₦46.15 billion in first half of 2020), mainly due to the growth recorded in income from fees on electronic products and account maintenance fee. During the period, income from fees on electronic products and account maintenance fee improved by 90.76% and 53.49% to ₦17.05 billion (H1'20: ₦8.94 billion) and ₦14.48 billion (H1'20: ₦9.43 billion) respectively. We may continue to see progressive results in income from fee & commission income in coming quarters as traffic in on-line banking is expected to continue to grow. This is expected to have significant impact on the non-interest income line of the bank in the second half of 2021.

Meanwhile, the total operating expenses of the bank increased by 10.31% to ₦149.85 billion in H1'21 (vs. ₦135.85 billion in H1'20), mainly due to higher expenses on information technology, bank charges, deposit insurance premium, AMCON levy, among others. Although the operating expenses of the bank increased by 10.31% in the first half of 2021, this is 774 bps lower than the inflation rate of 17.75% for the month of June 2021. This shows the commitment of the bank towards its cost-minimization strategy.

We may continue to see progressive results in income from fee & commission income in coming quarters due to improved traffic in on-line banking.

Fig. 4: Non-Int. Income & Total Op. Expense: 6M'20 – 12M'23F (Billion NGN)

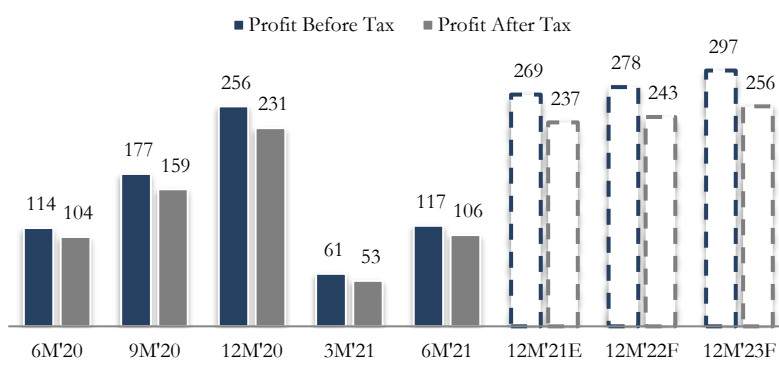


Source: NSE, Company's Results, PAC Research

Impressive non-interest income, lower interest expense and reduced impairment charge lift the profit before tax: In the first half of 2021, the impairment charge on financial and non-financial instruments fell by 17.24% to ₦19.80 billion (vs. ₦23.92 billion reported in first half of 2020) as the bank continued with proper and effective management of its earnings assets.

The impressive growth recorded in non-interest income, the lower interest expense and improved impairment charges reflected on the profitability of the bank as profit before tax rose by 2.57% to ₦117.06 billion in H1'21 (vs. ₦114.12 billion reported in H1'20). However, the bank made a provision of ₦10.94 billion for tax during the period (H1'20: ₦10.30 billion). Therefore, profit after tax improved by 2.21% to ₦106.12 billion in H1'21 (vs. ₦103.83 billion in H1'20) and resulted in 12-month trailing EPS of ₦7.42 during the period.

Fig. 5: PBT, Taxation and PAT – 6M'20 - FY'23F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

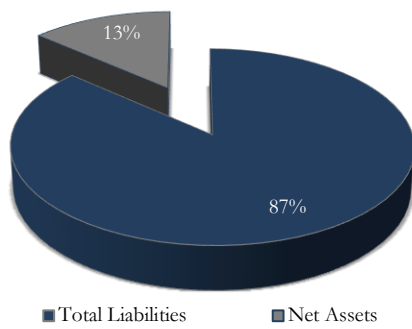
Balance Sheet remains strong: Zenith Bank rewards shareholders with interim dividend of ₦0.30 per share: The financial position of Zenith Bank remains solid and strong as the total assets of the bank increased by 12.34% to ₦8.52 trillion in the first half of 2021 (vs. ₦7.58 trillion in the first half of 2020), mainly driven by improved loans and advances to customers, higher treasury bills and investment securities, among others. However, the total liabilities of the bank increased by 11.85% to ₦7.37 trillion in H1'21 (vs. ₦6.59 trillion in H1'20), mainly magnified by higher deposits from customers and borrowings. Consequently, the net asset of the bank increased by 15.62% to ₦1.14 trillion in H1'21 (vs. ₦0.99 trillion in H1'20) and this translated to a higher net asset per share of ₦36.42 (H1'20: ₦31.50).

In addition to improved financial position, the liquidity ratio and capital adequacy ratio of the bank in the first half of 2021 are well above the regulatory requirement of 30% and 15% respectively. In the first half of 2021, the liquidity ratio and capital adequacy ratio of the bank increased to 59.0% (H1'20: 43.8%) and 22.0% (H1'20: 20.0%). However, the bank recorded a loan-to-deposit ratio of 61.6% in H1'21 (H1'20: 66.1%), which is below the regulatory minimum requirement of 65.0%, as the bank continued to monitor its loans and advances. This resulted in an improved non-performing loan of 4.51% in first half of 2021, when compared with 4.70% recorded in the first half of 2020).

In line with our expectation, the bank rewarded the shareholders with interim dividend payment of ₦0.30 per share in the first half of 2021 (vs. ₦0.30 in the first half of 2020). With the robust balance sheet, enhanced profitability in the first half and expectation of improved performance from the bank's major income lines, Zenith Bank may likely match the final dividend payment of previous year in FY'21. (fig. 7).

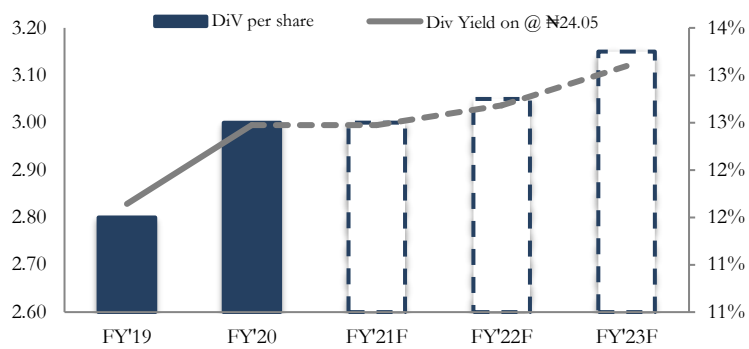
... Zenith Bank may likely match the final dividend payment of previous year in FY'21.

Fig. 6: Total Liabilities Vs Net Asset in H1'21



Source: Company's Presentation, PAC Research

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



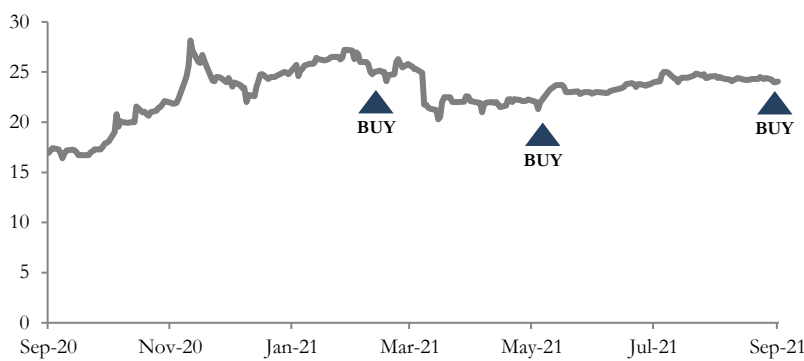
Source: Company's Presentation, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦30.82, representing an increase of 27.88% from the current price of ₦24.10. 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.

Our valuation puts the target price of the stock at N30.82, representing an increase of 27.88% from the current price of N24.10.

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	415,366	436,820	466,306
Change	-4.37%	-1.29%	5.17%	6.75%
Interest and Similar Expenses	-121,131	-91,444	-101,925	114,665
Change	-16.15%	-24.51%	11.46%	12.50%
Net Interest Income	299,682	323,922	334,896	351,640
Change	1.38%	8.09%	3.39%	5.00%
Impairment Charge for credit losses	-39,534	-42,205	-43,682	-38,222
Change	115.19%	6.76%	3.50%	12.50%
Fees and Commission Income	79,332	91,444	94,644	99,377
Change	-3.03%	15.27%	3.50%	5.00%
Trade gains	121,678	133,649	136,870	143,714
Change	51.71%	9.84%	2.41%	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	269,408	278,109	297,365
Change	10.43%	5.29%	3.23%	6.92%
Taxation	-25,296	-32,329	-34,764	-41,631
Change	-33.89%	27.80%	7.53%	19.75%
Profit After Taxation	230,565	237,079	243,345	255,734
Change	19.20%	2.83%	2.64%	5.09%

Table 6: Statement of Financial Position, N'mn

	2019	2020	2021E	2022F
Cash and balances	1,591,768	1,719,109	1,770,813	1,841,646
Treasury bills	1,577,875	1,704,105	1,675,094	1,742,097
Assets pledged as collateral	298,530	322,412	336,921	350,398
Due from other banks	810,494	875,334	861,477	895,936
Derivative assets	44,496	48,056	50,218	52,227
Loans and advances	2,779,027	3,001,349	3,232,452	3,361,750
Investment securities	996,916	1,076,669	1,125,119	1,170,124
Deffered tax assets	5,786	11,860	6,249	6,530
Other assets	169,967	77,395	183,564	239,299
Property and equipment	190,170	185,216	205,384	255,571
Total Assets	8,481,272	9,159,774	9,571,964	9,954,842
Customer deposits	5,339,911	6,045,451	6,221,776	6,470,647
Derivative Liabilities	11,076	11,962	12,500	13,000
Other liabilities	703,292	759,555	793,735	825,485
On lending facilities	384,573	415,339	434,029	451,390
Borrowings	870,080	686,983	717,897	746,613
Debt securities issued	43,177	46,631	48,730	50,679
Total Liabilities	7,363,799	7,978,546	8,241,861	8,571,536
Net Assets	1,117,473	1,181,227	1,330,102	1,383,306
Total equity and liabilities	8,481,272	9,159,774	9,571,964	9,954,842

Table 7: Profitability Ratio

	2019	2020	2021E	2022F
Return on Equity	20.63%	20.07%	18.30%	18.49%
Return on Assets	2.72%	2.59%	2.54%	2.57%
Net int. income to Rev.	43.03%	46.05%	46.00%	46.00%
PBT margin	36.74%	38.30%	38.20%	38.90%
Net Profit Margin	33.11%	33.70%	33.43%	33.45%
ROCE	4.10%	3.96%	4.02%	4.14%

Table 8: Asset Utilisation

	2019	2020	2021E	2022F
Cash/Revenue	228.55%	244.39%	243.23%	240.92%
Revenue to total assets (x)	8.21%	7.68%	7.61%	7.68%
Interest Inc. / Total Assets	4.96%	4.53%	4.56%	4.68%
Other Income/ Total Assets	0.60%	0.31%	0.32%	0.32%
Rev. to total fixed assets	366.22%	342.49%	284.87%	287.60%
fixed asset turnover	27.31%	29.20%	35.10%	34.77%

Table 9: Liquidity Ratios

	2019	2020	2021E	2022F
Current ratio	1.15	1.15	1.16	1.16
Cash ratio	0.22	0.22	0.21	0.21
Interest Coverage ratio	2.11	2.95	2.73	2.59
Liquid Assets/Total Deposit	0.78	0.74	0.73	0.73
Loans & Adv./Total Deposit	0.52	0.50	0.52	0.52
Liquid Assets/Total Assets	0.49	0.49	0.48	0.48
Debt/net income	3.96	3.09	3.15	3.12
Debt to asset	0.11	0.08	0.08	0.08
Debt to equity	0.82	0.62	0.58	0.58
Total Liabilities / Total Asset	0.87	0.87	0.86	0.86
Cost to income ratio	0.50	0.50	0.50	0.49
net interest margin AVERAGED	0.06	0.07	0.09	0.09
Total liabilities/equities	6.59	6.75	6.20	6.20

Table 10: Shareholders' Investment Ratios

	2019	2020	2021E	2022F
Earnings per share	7.34	7.55	7.75	8.15
DiV per share	3.00	3.00	3.05	3.15
NAVPS	35.59	37.62	42.36	44.06
Earnings yield	30.53%	31.40%	32.23%	33.87%

Table 11: Capital Adequacy Ratios

	2019	2020	2021E	2022F
Loans and Advances/Equity	2.49	2.54	2.43	2.43
Equity/Total Assets	0.13	0.13	0.14	0.14
Loan Loss Expense/ Equity	0.04	0.04	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

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