Zenith Bank Plc

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Zenith Bank Grows Net Income by 5% in H1-2022, Despite the Significant Increase in Tax Provision

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INVESTMENT SUMMARY

Zenith Bank delivered another impressive performance in the first half of 2022 as gross earnings improved by 17.13% to ₦404.76 billion (vs. ₦345.56 billion in the first half of 2021), driven by the strong growth in interest income and non-interest income. The total interest income of the bank rose by 18.53% to ₦241.73 billion in H1'22 (vs. ₦203.93 billion in H1'21), mainly driven by the elevated yield environment during the period. Also, the non-interest income of the bank increased by 17.52% to ₦148.98 billion in H1'22 (vs. ₦126.77 billion in H1'21), mainly as a result of strong growth in fees on electronic products and trading gain. Meanwhile, interest and similar expenses rose significantly by 29.52% to ₦56.98 billion in H1'22 (vs. ₦43.99 billion in H1'21) due to high yield environment and growth in funding base. The inflationary pressure, increase in regulatory cost and technology cost reflected in the operating expenses as it grew by 19.19% to ₦178.60 billion in H1'22 (vs. ₦149.85 billion in H1'21).

The impairment charge of the bank rose by 26.89% to ₦25.12 billion in H1'22 (vs. ₦19.80 billion in H1'21), driven by strong growth in loan book. The growth in the two major income lines of the bank overrides the increase recorded in impairment charge and operating expenses during the period. Hence, profit before tax grew by 11.06% to ₦130.01 billion in H1'22 (vs. ₦117.06 billion in H1'21). However, the bank made higher provision of ₦18.59 billion for tax in H1'22 (H1'21: ₦10.94 billion). Despite the higher tax provision, net profit grew by 4.99% to ₦111.41 billion in H1'22 (vs. ₦106.12 billion in H1'21), which resulted in a 12-month earnings per share of ₦7.96. The bank rewarded the shareholders with interim dividend of ₦0.30 per share in H1'22 (H1'21: ₦0.30). Based on the recent figures released by the bank and positive outlook in the coming quarters, we maintain a **BUY** rating on the stock at the current price of ₦21.25 as present forward estimate places the company share price at ₦31.14 (Previous Target Price: ₦32.04).

Table. 1: Quarterly results highlights

	2Q2022	1Q2022	2Q2021	Q/q Δ	Y/y Δ
Gross Earnings (₦'mn)	213,240	191,523	188,250	+11.34%	+13.27%
Net Int. Income (₦'mn)	84,204	100,539	76,772	-16.25%	+9.68%
Net profit (₦'mn)	53,215	58,198	53,059	-8.56%	+0.29%

Source: NGX, Bloomberg, PAC Research

Price:	
- Current	**₦21.25**
- Target	**₦31.14**
Recommendation:	**STRONG BUY**

** As at Thursday September 1, 2022*

Table. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-15.51%/-8.75%
52-week range	₦27.50 - ₦18.90
30-day Average vol.	10,457,140
Shares Outstanding ('mn)	31,396.49
Market Cap. (₦bn)	667.18
12-Month Trailing EPS (₦)	7.96
DPS (₦) - FY2021	3.10

Source: NGX, Bloomberg, PAC Research

Table. 3: Key ratios

	H1'22	H1'21
Net Interest Margin	7.10%	6.50%
Net Profit Margin	27.53%	30.71%
Equity Multiplier	7.95	7.45
Cash/ Total Assets	16.12%	16.73%

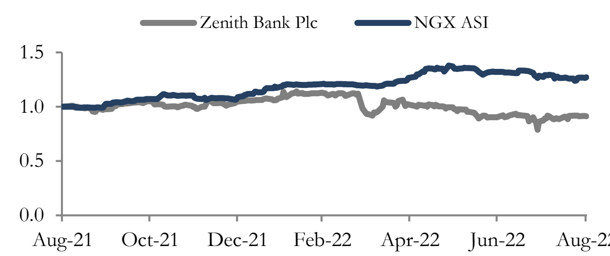
Source: NGX, PAC Research

Tab 4: Valuations

	FY2020	FY2021	FY2022E	FY2023F
P/E (x)	2.89	2.73	2.61	2.45
P/B (x)	0.60	0.52	0.51	0.46
Div Yield	14.12%	14.59%	15.06%	15.53%
Payout Ratio	40.85%	39.80%	39.37%	38.05%
EV/Revenue	1.58	1.11	0.98	0.96
Rev per share	22.18	24.38	26.94	28.83
ROE	20.63%	19.11%	19.64%	18.63%
ROA	2.72%	2.59%	2.40%	2.28%

Source: NGX, PAC Research

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



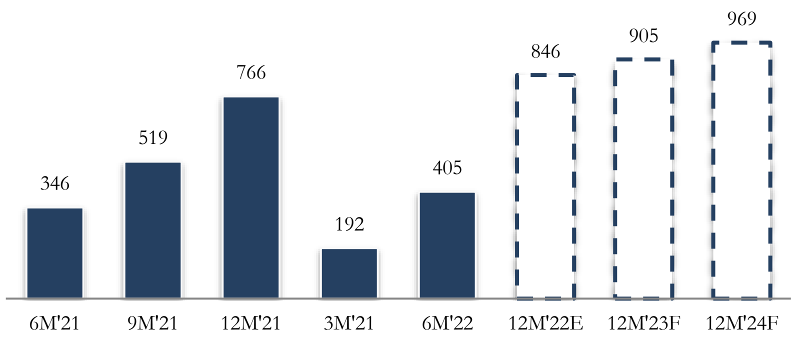
Source: Bloomberg, PAC Research

Gross earnings grow by 17% year-on-year, driven by improved interest income and non-interest income: In line with our expectations, the two major income lines (interest income and non-interest income) of Zenith Bank recorded impressive figures and lifted the gross earnings of the bank by 17.13% to ₦404.76 billion in the first half of 2022 (vs. ₦345.56 billion recorded in the first half of 2021). The total interest income of the bank improved by 18.53% to ₦241.73 billion in H1’22 (vs. ₦203.93 billion in H1’21). The growth in the interest income of the bank was driven by the elevated yield environment during the period. In addition, the non-interest income of the bank increased by 17.52% to ₦148.98 billion in H1’22 (vs. ₦126.77 billion in H1’21). Fees on electronic products, account maintenance fee/Commission on Turnover and trading income are the major drivers of the growth recorded in non-interest income during the period.

…gross earnings of Zenith bank will continue to improve in the remaining quarters of the years due to the expectation of improved interest-earning assets and recent rise in policy rate…

We maintain that the gross earnings of Zenith bank will continue to improve in the remaining quarters of the years due to the expectation of improved interest-earning assets and recent rise in policy rate in the country. Also, we maintain that increased patronisation and improved investment in electronic banking, such as POS, agency banking, mobile banking, internet banking and ATM transactions, will continue to raise non-interest income of the bank in the remaining quarters of the year.

Fig. 2: Grosss Earnings – 6M’21 – 12M’24F (Billion NGN)



Source: NGX, PAC Research

Interest income rises by 19% year-on-year, mainly driven by elevated yield environment: The decision of the Central Bank of Nigeria (CBN) to raise Monetary Policy Rate (MPR) by 150 basis points to 13.0% in the first half of 2022 had positive impact on yields on interest-earning assets of banks during the period. Consequently, the interest income increased significantly by 18.53% to ₦241.73 billion in H1’22 (vs. ₦203.93 billion in H1’21), driven by higher interest income from loans and advances, treasury bills, government and other bonds, among others. The interest income on loans and advances to customers improved by 20.67% to ₦163.41 billion in H1’22 (vs. ₦135.43 billion in H1’21).

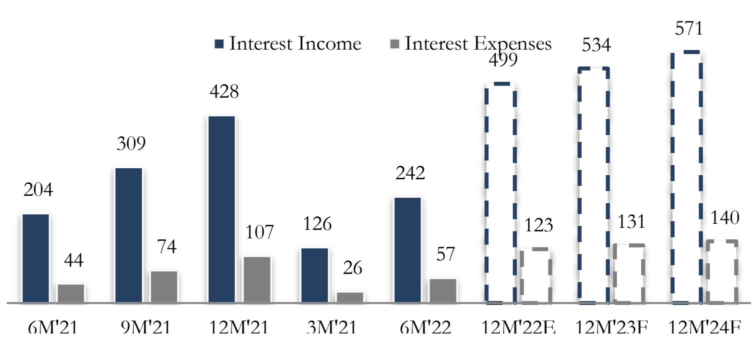
In addition, interest income from treasury bills and bonds (government and others) increased by 6.74% and 22.76% to ₦21.66 billion (H1'21: ₦20.29 billion) and ₦51.05 billion (H1'21: ₦41.58 billion) in H1'22 respectively.

Meanwhile, the high yield environment raised the cost of funds by 10 basis point to 1.4% in H1'22 (H1'21: 1.3%). The high cost of funds, in addition to the growth in funding base, elevated interest and similar expenses of the bank by 29.52% to ₦56.98 billion in H1'22 (vs. ₦43.99 billion in H1'21). Specifically, the total interest and similar expenses on current account, savings accounts and time deposits increased in H1'22 by 89.14%, 35.61% and 20.28% to ₦8.82 billion (H1'21: ₦4.67 billion), ₦9.85 billion (H1'21: ₦7.26 billion), and ₦17.13 billion (H1'21: ₦14.24 billion), respectively. In addition, the interest expenses on borrowed funds increased by 20.37% to ₦19.31 billion in H1'22 (vs. ₦16.04 billion in H1'21).

The high cost of funds, in addition to the growth in funding base, elevated interest and similar expenses of the bank by 29.52% to ₦56.98 billion in H1'22…

We maintain that the hike in policy rate and expectation of improved interest-earning assets will have positive impacts on the interest and similar income of the bank in the second half of 2022. However, the raising of minimum interest rates payables on local currency savings deposit from 10% to 30% of MPR by the CBN and expectation of higher funding base are expected to raise interest and similar expenses further in the second half of 2022.

Fig. 3: Interest Income and Interest Expenses: 6M'21 – 12M'24F (Billion NGN)



Source: NGX, PAC Research,

Trading gains, electronic products and account maintenance fees lift non-interest income by 18% (year-on-year): Zenith bank recorded total non-interest income of ₦148.98 billion in the first half of 2022, which is 17.52% higher than the ₦126.77 billion recorded in the first half of 2021. The key drivers of impressive non-interest income growth during the period are fees on electronic products, account maintenance fees and trading gains. Due to the significant increased patronage for internet banking, mobile banking, POS and USSD, the income from fee on electronic products increased significantly by 44.50% to ₦24.64 billion in H1'22 (vs. ₦17.05 billion in H1'21). In addition, the income from account maintenance fee increased by 24.31% to ₦19.77 billion in H1'22 (vs. ₦15.91 billion in H1'21).

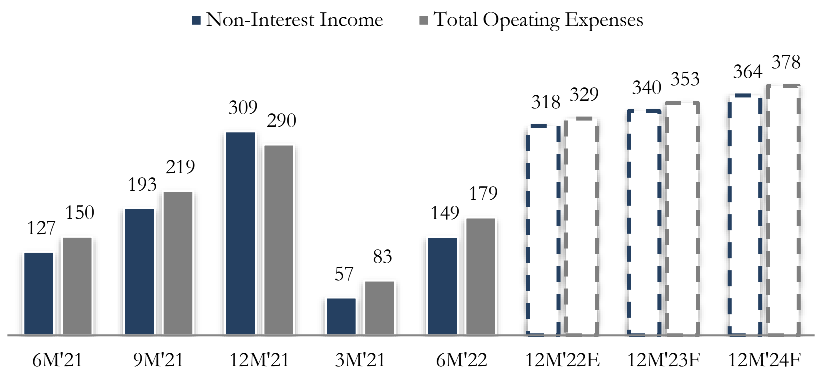
The trading income of the bank also accelerated by 43.72% to ₦85.19 billion in H1’22 (vs. ₦59.28 billion in H1’21), due to the significant increase in treasury bill trading income during the period.

The total operating expenses of the bank rose by 19.19% to ₦178.60 billion in H1’22 (vs. ₦149.85 billion in H1’21), mainly driven by higher regulatory cost, technology cost and general inflationary pressures. Consequently, the cost-to-income ratio rose by 180 basis point to 57.9% in H1’22 (H1’21: 56.1%).

We maintain that Zenith Bank may continue to witness significant increase in the operating expenses due to the rising inflation in the country and higher energy cost (especially diesel). In addition, the expectation of improved financial position will raise regulatory costs in coming quarters.

…Zenith Bank may continue to witness significant increase in the operating expenses due to the rising inflation in the country and higher energy cost …

Fig. 4: Non-Int. Income & Total Op. Expense: 6M’21 – 12M’24F (Billion NGN)

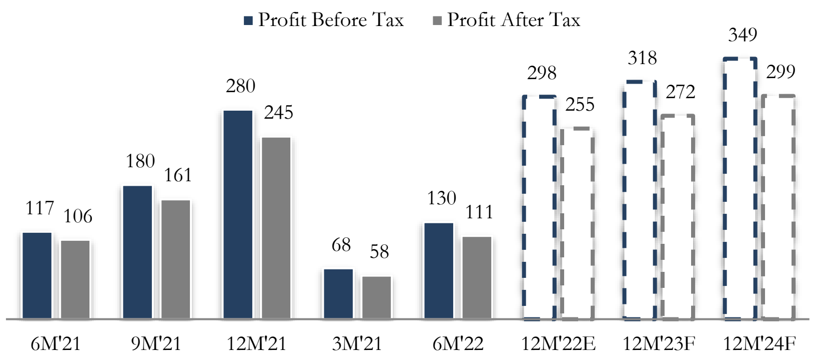


Source: NGX, PAC Research

Net Profit rises by 5% year-on-year, despite the significant increase in impairment charge and tax provision: In the second half of 2022, impairment charge on financial and non-financial instruments rose significantly by 26.89% to ₦25.12 billion in H1’22 (vs. ₦19.80 billion in H1’21). The increase in the bank’s impairment charge was mainly driven by the expansion in loan book, which resulted in 63% increase in expected credit losses on loans and advances during the period. It should be noted that expected credit losses on loans and advances constituted over 90% of the total impairment charges during the period.

The growth recorded in the interest income and non-interest income outweighed the setback recorded in operating expenses, interest expenses and impairment charge during the period. Consequently, profit before tax increased by 11.06% to ₦130.0 billion in H1’22 (vs. ₦117.06 billion H1’21). Meanwhile, the resumption of tax collection on income tax on bonds, and short-term securities raised the tax provision of the bank significantly by 69.95% to ₦18.59 billion in H1’22 (H1’21: ₦10.94 billion). Notwithstanding the higher tax provision and impairment charge, net profit grew by 4.99% to ₦111.41 billion in H1’22 (vs. ₦106.12 billion in H1’21), which resulted in a 12-month trailing earnings per share (EPS) of ₦7.96.

Fig. 5: PBT, Taxation and PAT – 6M'21 – 12M'24F (Billion NGN)



Source: NGX, PAC Research

Balance Sheet remains robust: Zenith Bank rewards shareholders with interim dividend of ₦0.30 per share: The financial position of Zenith Bank remained solid and strong as the total assets of the bank increased by 18.79% to ₦10.12 trillion in second quarter of 2022 (vs. ₦8.52 trillion in the second quarter of 2021), mainly driven by improved loans and advances to customers, higher treasury bills and investment securities, among others. The loans and advances of the bank increased significantly by 23.32% to ₦3.50 trillion in Q2'22 (vs. ₦2.84 trillion in Q2'21). Upstream Oil & Gas accounted for 17.9% of the total gross loans, followed by government (15.3%), General Commerce (13.1%) **(fig. 6).** However, the non-performing loan ratio of the bank improved to 4.4% in Q2'22 (Q2'21: 4.51%), with Oil & Gas sector accounted for 32.03% of the total non-performing loans, followed by General Commerce sector (23.68%), Communication sector (23.15) (**fig. 7).**

Upstream Oil & Gas accounted for 17.9% of the total gross loans, followed by government (15.3%), General Commerce (13.1%).

Fig. 6: Gross Loans by Sector – H1'22

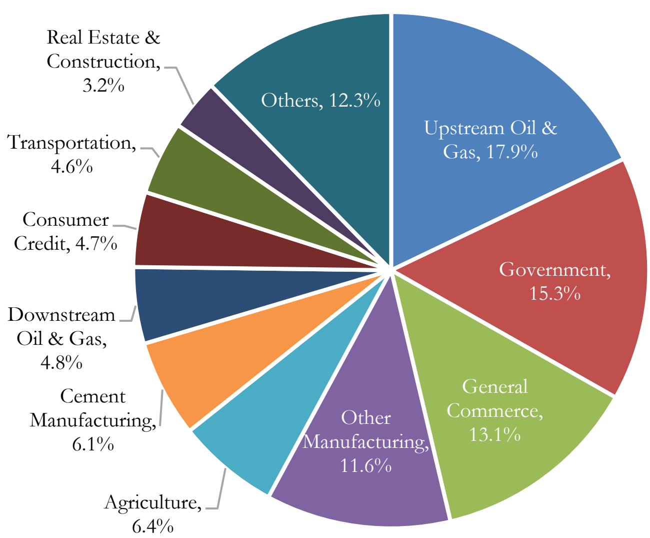
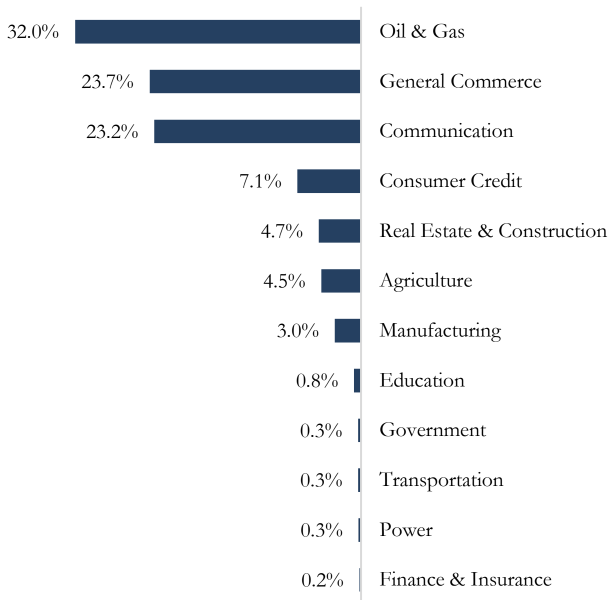


Fig. 7: Non-Performing Loans by Sector – H1'22



Source: Zenith Bank, PAC Research

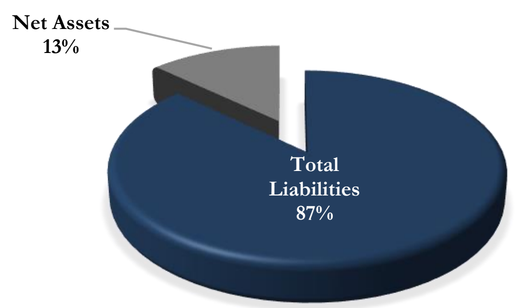
…the liquidity ratio and capital adequacy ratio of the bank in the second quarter of 2022 are well above the regulatory requirement of 30% and 16% respectively.

However, the total liabilities of the bank increased by 19.95% to ₦8.84 trillion in Q2'22 (vs. ₦7.37 trillion in Q2'21), mainly boosted by higher deposits from customers. Consequently, the net asset of the bank increased by 11.27% to ₦1.27 trillion in Q2'22 (vs. ₦1.14 trillion in Q2'21) and this translated to a higher net asset per share of ₦40.52 (Q2'21: ₦36.42).

In addition to improved financial position, the liquidity ratio and capital adequacy ratio of the bank in the second quarter of 2022 are well above the regulatory requirement of 30% and 16% respectively. In the second quarter of 2022, the liquidity ratio of the bank increased to 60.5% (Q2'21: 59.0%) while the capital adequacy ratio remains at 21.0% (Q2'21: 22.0%). However, the bank recorded a loan-to-deposit ratio of 57.8% in Q2'22 (Q2'21: 61.6%), which is below the regulatory minimum requirement of 65.0%, as the bank continued to monitor its loans and advances.

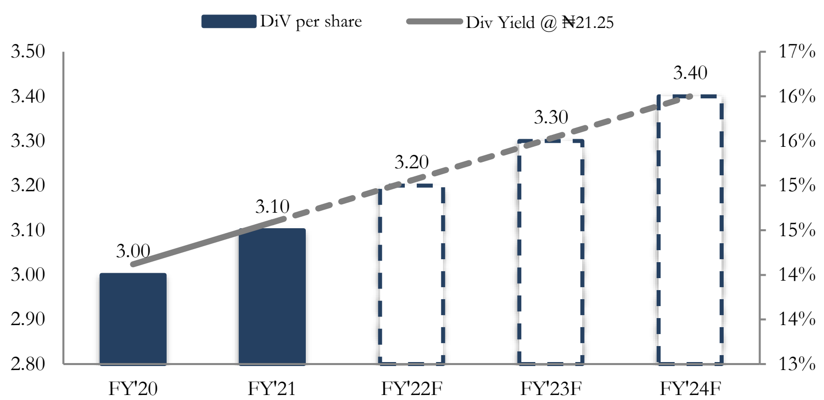
In line with our expectation, the bank rewarded the shareholders with interim dividend payment of ₦0.30 per share in the first half of 2022 (vs. ₦0.30 in the first half of 2021). With the current strong financial position, higher net profit in the first half of 2022 and expectation of improved performance from the bank's major income lines, shareholder may be rewarded with impressive dividend payment in the full year of 2022. **(fig. 9)**

Fig. 8: Total Liabilities Vs Net Asset in Q2'22



Source: NGX, PAC Research

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



Source: NGX, PAC Research

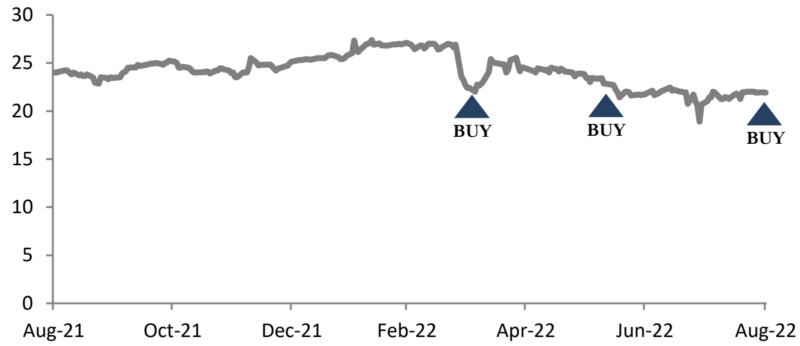
Valuation

Our valuation puts the target price of the stock at ₦31.14, representing an increase of 46.56% from the current price of ₦21.25. In arriving at the target price, we employed Dividend Discount Valuation Methodology. Consequently, we maintain a **BUY** recommendation on the stock of the company.

Our valuation puts the target price of the stock at ₦31.14, representing an increase of 46.56% from the current price of ₦21.25.

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 bank's management.

Fig. 10: Share Price History (Naira)



Source: NGX, PAC Research

Table 5: Statement of Profit or Loss, N'mn

	2020	2021	2022E	2023F
Gross Earnings	696,450	765,558	845,942	905,158
Change	5.16%	9.92%	10.50%	7.00%
Interest and Similar Income	420,813	427,597	499,106	534,043
Change	1.26%	1.61%	16.72%	7.00%
Interest and Similar Expenses	-121,131	-106,793	-122,662	-131,248
Change	-18.45%	-11.84%	14.86%	7.00%
Net Interest Income	299,682	320,804	376,444	402,795
Change	12.23%	7.05%	17.34%	7.00%
Impairment Charge for credit losses	-39,534	-59,932	-67,675	-72,413
Change	64.51%	51.60%	12.92%	7.00%
Fees and Commission Income	79,332	103,958	131,121	140,299
Change	-20.75%	31.04%	26.13%	7.00%
Trade gains	121,678	167,483	186,107	199,135
Change	3.29%	37.64%	11.12%	7.00%
Personnel expenses	-79,520	-79,885	-88,824	-95,042
Change	2.13%	0.46%	11.19%	7.00%
Profit Before Taxation	255,861	280,374	297,771	317,710
Change	5.17%	9.58%	6.21%	6.70%
Taxation	-25,296	-35,816	-42,581	-45,433
Change	-26.57%	41.59%	18.89%	6.70%
Profit After Taxation	230,565	244,558	255,190	272,278
Change	10.40%	6.07%	4.35%	6.70%

Table 6: Statement of Financial Position, N'mn

	2020	2021	2022E	2023F
Cash and balances	1,591,768	1,488,363	1,615,581	1,793,614
Treasury bills	1,577,875	1,764,945	2,104,507	2,367,570
Assets pledged as collateral	298,530	392,594	425,153	478,297
Due from other banks	810,494	691,244	744,018	837,020
Derivative assets	44,496	56,187	81,842	92,072
Loans and advances	2,779,027	3,355,728	3,613,800	4,065,525
Investment securities	996,916	1,303,726	1,466,778	1,590,338
Deffered tax assets	5,786	12,013	11,860	13,850
Other assets	169,967	140,941	77,395	197,820
Property and equipment	190,170	176,182	185,216	186,764
Total Assets	8,481,272	9,447,843	10,628,823	11,957,426
Customer deposits	5,339,911	6,472,054	7,546,465	8,489,773
Derivative Liabilities	11,076	14,674	13,881	15,616
Other liabilities	703,292	487,432	584,585	657,658
On lending facilities	384,573	369,241	372,009	418,510
Borrowings	870,080	750,469	744,018	837,020
Debt securities issued	43,177	45,799	54,110	60,874
Total Liabilities	7,363,800	8,168,181	9,329,717	10,495,931
Net Assets	1,117,472	1,279,662	1,299,107	1,461,495
Total equity and liabilities	8,481,272	9,447,843	10,628,823	11,957,426

Tab. 7: Profitability Ratio

	2020	2021	2022E	2023F
Return on Equity	20.63%	19.11%	19.64%	18.63%
Return on Assets	2.72%	2.59%	2.40%	2.28%
Net int. income to Rev.	43.03%	41.90%	44.50%	44.50%
PBT margin	36.74%	36.62%	35.20%	35.10%
Net Profit Margin	33.11%	31.95%	30.17%	30.08%
ROCE	4.10%	4.07%	3.71%	3.52%

Tab. 8: Asset Utilisation

	2020	2021	2022E	2023F
Cash/Revenue	228.55%	194.42%	190.98%	198.15%
Revenue to total assets (x)	8.21%	8.10%	7.96%	7.57%
Interest Inc. / Total Assets	4.96%	4.53%	4.70%	4.47%
Other Income/ Total Assets	0.60%	0.40%	0.00%	0.00%
Rev. to total fixed assets	366.22%	382.76%	354.96%	337.60%
fixed asset turnover	27.31%	26.13%	28.17%	29.62%

Tab. 9: Liquidity Ratios

	2020	2021	2022E	2023F
Current ratio	1.15	1.16	1.14	1.14
Cash ratio	0.22	0.18	0.17	0.17
Interest Coverage ratio	2.11	2.63	2.43	2.42
Liquid Assets/Total Deposit	0.78	0.70	0.69	0.68
Loans & Adv./Total Deposit	0.52	0.52	0.48	0.48
Liquid Assets/Total Assets	0.49	0.48	0.49	0.48
Debt/net income	3.96	3.26	3.13	3.30
Debt to asset	0.11	0.08	0.08	0.08
Debt to equity	0.82	0.62	0.61	0.61
Total Liabilities / Total Asset	0.87	0.86	0.88	0.88
Cost to income ratio	0.50	0.51	0.52	0.53
net interest margin AVERAGED	0.08	0.07	0.07	0.08
Total liabilities/equities	6.59	6.38	7.18	7.18

Tab. 10: Shareholders' Investment Ratios

	2020	2021	2022E	2023F
Earnings per share	7.34	7.79	8.13	8.67
DiV per share	3.00	3.10	3.20	3.30
NAVPS	35.59	40.76	41.38	46.55
Earnings yield	34.56%	36.66%	38.25%	40.81%

Tab. 11: Capital Adequacy Ratios

	2020	2021	2022E	2023F
Loans and Advances/Equity	2.49	2.62	2.78	2.78
Equity/Total Assets	0.13	0.14	0.12	0.12
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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