

## Higher Interest Income and Efficient Cost Management Drives Profitability

### INVESTMENT SUMMARY

The 2019 unaudited first quarter reports released by the Zenith Bank Plc showed a lower figure for top-line, when compared with the figure of corresponding quarter of the previous year. Due to a reduced non-interest income, gross earnings declined by 6.55% to ₦158.11 billion in Q1'19 (vs. ₦169.19 billion in Q1'18). Non-interest income declined by 32.11% to ₦35.63 in Q1'19 (vs. ₦52.48 billion recorded in Q1'18), mainly as a result of lower trading income and compressed operating income during the period. However, the bank recorded improved performance for interest income as it rose by 4.94% to ₦122.48 billion in Q1'19 (vs. ₦116.71 billion in Q1'18). The improvement in the interest income is mainly attributed to the higher interest income from treasury bills, bonds and placement with banks and discount houses.

Impressively, the bank reported lower figures, for impairment charge, as it reduced by 54.17% to ₦2.10 billion in Q1'19 (vs. ₦4.57 billion in Q1'18). The bank also recorded impressive figures for interest expenses and operating expenses as they declined by 22.21% and 3.72% to ₦36.34 billion (Q1'18: ₦46.72 billion) and ₦59.40 billion (Q1'18: ₦61.70 billion) respectively in Q1'19. Due to lower aggregate expenses during the period, profit before tax increased by 6.10% to ₦57.29 billion in Q1'19 (vs. ₦54.00 billion in Q1'18). However, the bank made a provision of ₦7.06 billion for tax (vs. ₦6.92 billion in Q1'18) and as a result, profit after tax increased by 6.67% to ₦50.23 billion in Q1'19 (vs. ₦47.08 billion in Q1'18). Impressively, 12-month trailing EPS improved by 4.83% to ₦6.26, from ₦5.97 recorded in the previous period. Based on the recent figures released by the bank, we maintain a **BUY** rating on the stock at the current price of ₦20.90 as present forward estimate places the company share price at ₦32.29 (Previous target price: ₦34.23).

Fig. 1: Quarterly results highlights

	1Q2019	4Q2018	1Q2018	Q/q Δ	Y/y Δ
Gross Earnings (₦mn)	158,111	155,737	169,192	+1.52%	- 6.55%
Net Int. Income (₦mn)	86,137	67,077	69,992	+28.42%	+23.07%
Net profit (₦mn)	50,234	49,245	47,079	+2.01%	+6.70%

Source: NSE, Bloomberg, PAC Research

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Price:

- Current	₦20.55
- Target	₦32.29

Recommendation: **STRONG BUY**

\* As at Tuesday May 7, 2019

Fig. 2: Stock data

	December
FYE	
Price Mov't: YtD / 52wk	-25.27%/-10.85%
52-week range	₦29.00- ₦19.60
30-day Average vol.	21,225,740
Shares Outstanding (mn)	31,396.49
Market Cap. (₦bn)	645.20
EPS (₦) - 12months trailing	6.26
DPS (₦) - FY2018	2.80

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	Q1'19	Q1'18
Net Interest Margin	8.90%	9.30%
Net profit margin	31.77%	27.83%
Equity multiplier	7.53	7.72
Cash/ total Assets	16.43%	16.58%

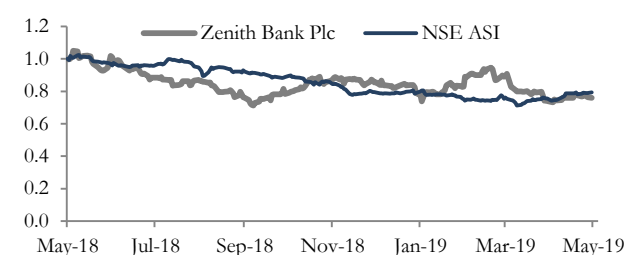
Source: NSE, Bloomberg, PAC Research

Fig. 4: Valuations

	FY2017	FY2018	FY2019F	FY2020F
P/E (x)	3.63	3.34	3.17	2.96
P/B (x)	0.79	0.79	0.78	0.74
Div Yield	13.14%	13.63%	14.11%	14.60%
Payout Ratio	47.64%	45.45%	44.66%	43.15%
EV/Revenue	1.36	1.79	1.83	1.77
Rev per share	23.73	20.08	19.79	20.97
ROE	21.91%	23.71%	24.76%	24.92%
ROA	3.18%	3.25%	3.45%	3.48%

Source: NSE, Bloomberg, PAC Research

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



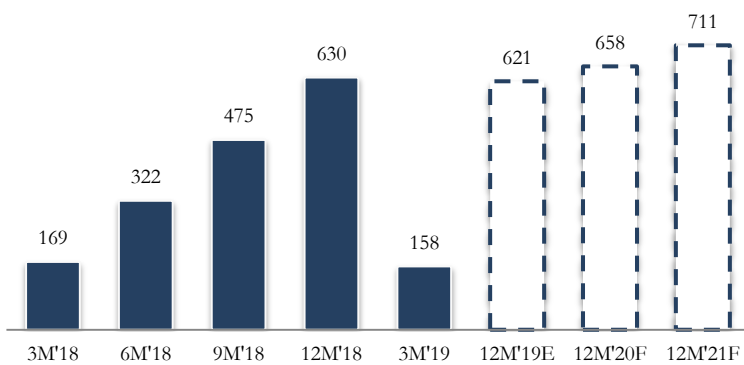
Source: Bloomberg, PAC Research

### Gross earnings declines by 6.55% year-on-year, due to lower non-interest income

In the first quarter of 2019, the figure released by the bank for the gross earnings fell by 6.55% to ₦158.11 billion (vs ₦169.19 billion in the first quarter of 2018), as a result of significant drop in non-interest income. The bank's non-interest income dropped by 32.11% to ₦35.63 billion in Q1'19 (vs. ₦52.48 billion Q1'18). The drop in non-interest income can be linked to a significant decline in trading income and operating income during the period. However, the bank reported improved number for interest and similar income as it increased by 4.94% to ₦122.48 billion in three-month to March 2019 (vs. ₦116.71 billion reported in three-month to March 2018). The improvement in interest income can be mainly attributed to the higher interest income from treasury bills, improved income from government and other bonds and progressive income from placement with banks & discount houses.

*The drop in non-interest income can be linked to a significant decline in trading income and operating income during the period*

Fig. 6: Gross Earnings – 3M'18 –12M'21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

### Even with reduction in interest income from loans and advances to customers, total interest income rises by 7.28% year-on-year

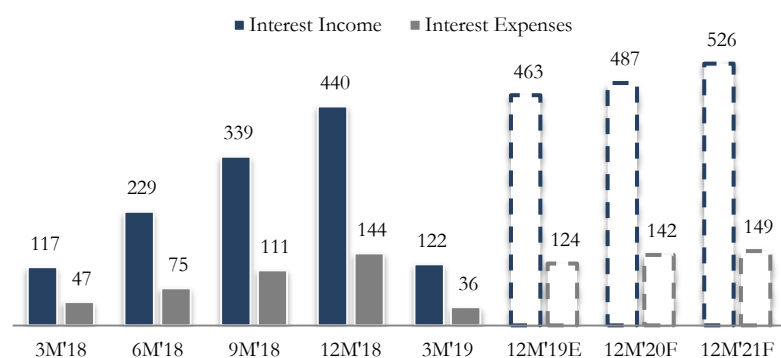
In three-month to March 2019, the bank reported a lower figure for interest income from loans and advances to customers as it declined by 24.37% to ₦58.30 billion in Q1'19 (vs. ₦77.08 billion in Q1'18). However, the bank reported improved figures for interest income from treasury bills, government & other bonds and placement with banks and discount houses during the period under review. Interest income from treasury bills increased by 69.98% to ₦42.41 billion (vs. ₦24.95 billion in Q1'18) while interest income from government & other bonds increased 29.98% to ₦16.65 billion in Q1'19 (vs. ₦12.81 billion in Q1'18). In addition, interest income from placement with banks and discount houses rose significantly by 162.13% to ₦4.89 billion in Q1'19 (vs. ₦1.87 billion in Q1'18).

*...the bank reported improved figures for interest income from treasury bills, government & other bonds and placement with banks and discount houses...*

The increase in interest income from treasury bills, bonds and placements outweighed the lower drop in interest income from loans and advances to customers and this translated to improved total interest income as it increased by 4.94% to ₦122.48 billion in Q1'19 (vs. ₦116.71 billion in Q1'8).

Due to a significant reduction in interest expenses on time deposits, borrowed funds and savings accounts, total interest expenses fell by 22.21% to ₦36.34 billion in Q1'19 (vs. ₦46.72 billion in Q1'18). Total interest expenses on time deposits declined by 12.62% to ₦10.81 billion (vs. ₦12.37 billion reported in Q1'18) while interest expenses on borrowed funds declined by 32.46% to ₦17.97 billion (vs. ₦26.60 billion reported in Q1'18). Savings account declined by 4.46% to ₦4.57 billion (vs. ₦4.78 billion reported in Q1'19). However, the bank recorded higher interest expenses on current accounts as it rose by 1.08% to ₦3.01 billion in Q1'19 (vs. ₦2.98 billion in Q1'18).

Fig. 7: Interest Income and Interest Expenses: 3M'18-12M'21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research,

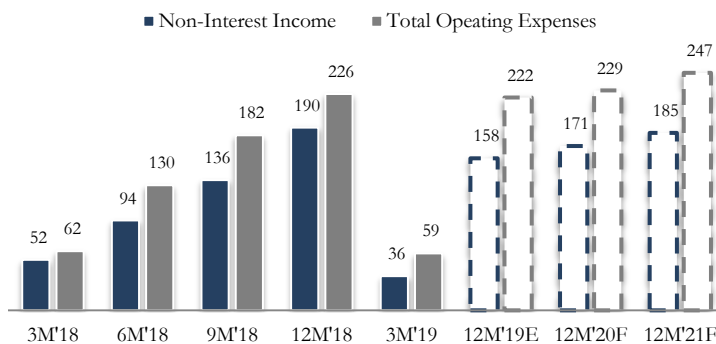
### Lower operating income weaken the effects of reduced non-interest income

Zenith Bank Plc reported an unimpressive figure for non-interest income as it declined by 32.11% to ₦35.63 billion in the first quarter of 2019 (vs. ₦52.80 billion reported in the first quarter of 2018). The significant drop in non-interest income can be mainly ascribed to trading income and other operating income. Due to a derivatives loss of ₦6.09 billion (Q1'18: Gain of ₦1.02 billion) and lower T-bills trading income of ₦12.23 billion (Q1'18: ₦25.91 billion), total trading income declined by 71.72% to ₦7.81 billion in Q1'19 (Q1'18: ₦27.62 billion). In addition, other operating income such as income on cash handling and foreign currency revaluation gain declined during the period.

*Due to a derivatives loss of ₦6.09 billion (Q1'18: Gain of ₦1.02 billion) and lower T-bills trading income of ₦12.23 billion (Q1'19: ₦25.91 billion), total trading income declined by 71.72%*

However, we are impressed with the cost optimisation of the company, mirrored in the lower operating expenses achieved in three-month to March 2019. As a result of lower training and development expenses, reduced fuel and maintenance expenses, lower expenses on insurances and reduced corporate promotions expenses, total operating expenses declined by 3.72% to ₦59.40 billion in Q1'19, from ₦61.70 billion reported in Q1'18. Meanwhile, depreciation of property and equipment increased by 22.14% to ₦4.75 billion (vs. ₦3.89 billion in Q1'18) while personnel expenses also increased by 17.49% to ₦18.29 billion in Q1'19 (vs. ₦15.57 billion in Q1'18).

Fig. 8: Non-Int. Income & Total Op. Expense: 3M'18-12M'21F (Billion NGN)



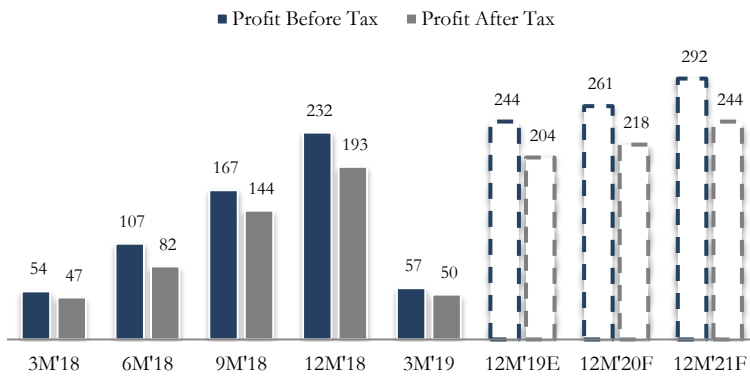
Source: NSE, Company's Results, PAC Research

### PBT increases by 6.10%, due to higher interest income, cost optimisation and lower impairment charges

During the period under review, the cost of risk dropped significantly to 0.40% in first quarter of 2019, from 0.90% recorded in first quarter of 2018. This was achieved as impairment charges declined by 54.17% to ₦2.10 billion in Q1'19 (vs. ₦4.57 billion in Q1'18). The bank's cost of funds also improved, declining by 25.00% to 3.00% in Q1'19 (Q1'18: 4.00%). This was supported by a 22.21% decrease in interest expenses, affirming the bank's robust treasury and liquidity management. The bank's prudent cost management reflected in cost-to-income ratio as it declined by 240bps to 50.90% in Q1'19 (vs. 53.30% in Q1'18). With lower impairment charge, higher interest income generated during the period and efficient cost management, profit before tax increased by 6.10% to ₦57.29 billion in Q1'19 (vs. ₦54.00 billion reported in Q1'18). The bank made a provision of ₦7.06 billion for tax during the period (Q1'19: ₦6.92 billion), representing an increase of 1.98%. Consequently, profit after tax improved by 6.70% to ₦50.23 billion in Q1'19 (vs. ₦47.08 billion Reported in Q1'18). Impressively, earnings per share (EPS) increased by 4.83% to ₦6.26 in Q1'19, from ₦5.97 the bank achieved in Q1'18.

*The bank's prudent cost management reflected in cost-to-income ratio as it declined by 240bps to 50.90% in Q1'19 (vs. 53.30% in Q1'18)*

Fig. 9: Profit before Tax and Profit after Tax – 3M'18-12M'21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

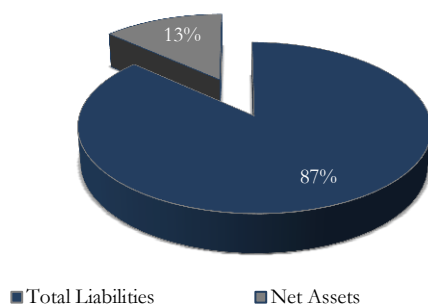
**Balance sheet remains healthy and solid; Expectation of impressive interim dividends in half year of 2019**

The bank’s consistency in solid and improved balance sheet continued in first quarter of 2019, mirrored in the robust liquidity ratio, capital adequacy ratio and lower non-performing loans ratio. Liquidity and Capital Adequacy Ratio of the bank are well above industry requirements of 30% for liquidity ratio and 15% for capital adequacy ratio. The liquidity ratio remained at 66.70% (Q1'18: 69.7%) while capital adequacy ratio stayed at 25.00% (Q1'18: 25.00%). The bank continued to monitor its loans portfolio, resulted in lower loan-to-deposit ratio of 43.00% (Q1'18: 44.20%) and lower non-performing loan ratio of 4.85% in Q1'19 (Q1'18: 4.98%).

Total assets rose by 3.58% to ₦5.88 trillion in Q1'19 (vs. ₦5.68 trillion in Q1'18) while total liabilities rose by 3.19% to ₦5.10 trillion in Q1'19 (vs. ₦4.94 trillion in Q1'18). Consequently, net asset increased by 6.21% to ₦780.89 billion in Q1'19 (vs. ₦735.25 billion in Q1'18), translated to a net asset per share of ₦24.87 (Q1'18: ₦23.42). With improved 12-month earnings per share, we expect impressive interim dividend payment from the bank in half year of 2019.

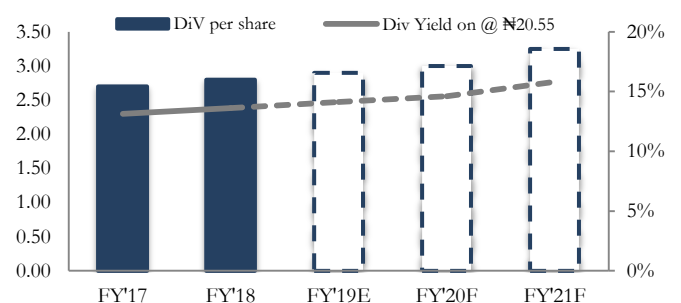
*The bank continued to monitor its loans portfolio, resulted in lower loan-to-deposit ratio of 43.00% (Q1'18: 44.20%) and lower non-performing loan ratio of 4.85% in Q1'19 (Q1'18: 4.98%).*

Fig. 10: Total Liabilities Vs Net Asset in Q1'19



Source: Company's Presentation, PAC Research

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



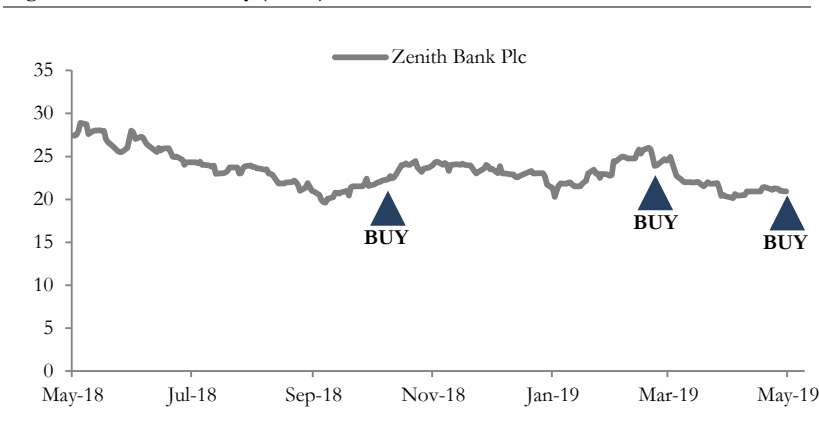
**Valuation**

Our valuation puts the target price of the stock at ₦32.29, representing an increase of 57.13% from the current price of ₦20.55. 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 N32.29, representing an increase of 57.13% from the current price of N20.55*

**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	462,797	487,272
Change		-7.28%	5.17%	5.29%
Interest and Similar Expenses	-216,637	-144,458	-124,241	141,572
Change		-33.32%	-14.00%	13.95%
Net Interest Income	257,991	295,594	338,556	345,700
Change		14.58%	14.53%	2.11%
Impairment Charge for credit losses	-98,227	-18,372	-9,318	-7,902
Change		-81.30%	-49.28%	15.20%
Fees and Commission Income	90,143	81,814	86,969	93,504
Change		-9.24%	6.30%	7.51%
Trade gains	157,974	80,202	31,060	36,216
Change		-49.23%	-61.27%	16.60%
Personnel expenses	-64,459	-68,556	-70,817	-74,408
Change		6.36%	3.30%	5.07%
Profit Before Taxation	203,461	231,685	244,133	261,415
Change		13.87%	5.37%	7.08%
Taxation	-25,528	-38,261	-40,282	-43,133
Change		49.88%	5.28%	7.08%
Profit After Taxation	177,933	193,424	203,851	218,282
Change		8.71%	5.39%	7.08%

**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%	24.76%	24.92%
Return on Assets	3.18%	3.25%	3.45%	3.48%
Net int. income to Rev.	34.62%	46.89%	54.50%	52.50%
PBT margin	27.30%	36.76%	39.30%	39.70%
Net Profit Margin	23.88%	30.69%	32.82%	33.15%
ROCE	5.12%	5.36%	5.72%	5.78%

**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%	7.82%	7.77%
Other Income/ Total Assets	0.40%	0.30%	0.32%	0.37%
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	1.17	1.17
Cash ratio	0.20	0.19	0.19	0.19
Interest Coverage ratio	0.94	1.60	1.57	1.72
Liquid Assets/Total Deposit	0.65	0.68	0.72	0.72
Loans & Adv./Total Deposit	0.61	0.49	0.54	0.54
Liquid Assets/Total Assets	0.40	0.42	0.44	0.44
Debt/net income	3.87	4.13	4.03	3.76
Debt to asset	0.12	0.13	0.14	0.14
Debt to equity	0.85	0.98	0.94	0.94
Total Liabilities / Total Asset	0.85	0.86	0.85	0.85
Cost to income ratio net interest margin AVERAGED	0.53	0.49	0.48	0.45
Total liabilities/equities	5.89	6.30	5.88	5.88

**Fig. 20: Shareholders' Investment Ratios**

	2017	2018	2019E	2020F
Earnings per share	5.67	6.16	6.49	6.95
DiV per share	2.70	2.80	2.90	3.00
NAVPS	25.87	25.98	26.23	27.90
Earnings yield	27.12%	29.48%	31.07%	33.27%

**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	0.01	0.01

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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