

PBT Grows by 3.80% notwithstanding the Setback in Interest Income Line

INVESTMENT SUMMARY

Zenith Bank kicked off the year with impressive performance, posting 3.80% growth in profit before tax (₦61.02 billion in Q1'21 vs. ₦58.79 billion in Q1'20). However, the top-line contracted as gross earnings declined by 5.70% to ₦157.31 billion in the first quarter of 2021 (vs. ₦166.81 billion in first quarter of 2020). The reduction in the gross earning was mainly driven by the setback recorded in the interest income line of the bank. As a result of lower yields in the fixed income market in the first quarter of 2021, which adversely impacted yields on marketable securities and the pricing of risk assets, the total interest income fell by 11.51% to ₦101.18 billion (vs. ₦114.33 billion reported in the corresponding quarter of the previous year). However, the non-interest income of the bank improved by 9.78% to ₦51.20 billion in Q1'21 (vs. ₦46.64 billion in Q1'20), due to the growth recorded in credit related fees and fees on electronic products. Impressively, the bank benefited from the lower yield environment, which reflected on lower cost of funds of 1.1% in Q1'21 (Q1'20: 2.6%), as interest & similar expense fell by 45.15% to ₦18.01 billion (vs. ₦32.83 billion in Q1'20). Compared to other Tier 1 Banks, Zenith Bank managed its loans and advances very well as impairment charge fell by 2.43% to ₦3.86 billion in Q1'21 (vs. ₦3.95 billion in Q1'20).

With impressive performance from non-interest income line and optimisation of cost of funds, profit before tax improved by 3.80% to ₦61.02 billion in Q1'21 (vs. ₦58.79 billion in Q1'20). The bank made a lower provision of ₦7.96 billion for tax in Q1'21 (Q1'20: ₦8.26 billion). Consequently, profit after tax rose by 5.02% to ₦53.06 billion (vs. ₦50.53 billion in Q1'20) and this translated to 12-month trailing EPS of ₦7.42, from ₦6.66 recorded in the corresponding previous period. Based on the recent figures released by the bank, we maintain a **BUY** rating on the stock at the current price of ₦21.95 as present forward estimate places the company share price at ₦30.78 (Previous TP: ₦30.29).

Fig. 1: Quarterly results highlights

	1Q2021	4Q2020	1Q2020	Q/q Δ	Y/y Δ
Gross Earnings (₦mn)	157,309	187,475	166,814	-16.09%	-5.70%
Net Int. Income (₦mn)	83,168	74,503	81,501	+11.63%	+2.05%
Net profit (₦mn)	53,060	71,250	50,526	-25.53%	+5.02%

Source: NSE, Bloomberg, PAC Research

May 7, 2021

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Price:

- Current	₦21.95
- Target	₦30.78
Recommendation:	BUY

* As at Thursday May 6, 2021

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-11.49%/+47.81%
52-week range	₦28.50 - ₦14.80
30-day Average vol.	18,545,609
Shares Outstanding (mn)	31,396.49
Market Cap. (₦bn)	689.15
12-Month Trailing EPS (₦)	7.42
DPS (₦) - FY2020	3.00

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	Q1'21	Q1'20
Net Interest Margin	6.00%	7.70%
Net profit margin	33.73%	30.29%
Equity multiplier	7.95	7.70
Cash/ total Assets	20.32%	17.94%

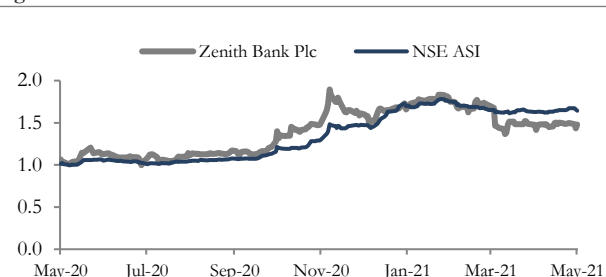
Source: NSE, Bloomberg, PAC Research

Fig. 4: Valuations

	FY2019	FY2020	FY2021F	FY2022F
P/E (x)	3.30	2.99	2.91	2.87
P/B (x)	0.73	0.62	0.61	0.52
Div Yield	12.76%	13.67%	13.67%	14.12%
Payout Ratio	42.09%	40.85%	39.79%	40.49%
EV/Revenue	1.32	1.58	1.22	1.23
Rev per share	21.09	22.18	22.85	23.65
ROE	22.17%	20.63%	20.85%	18.07%
ROA	3.29%	2.72%	2.58%	2.51%

Source: NSE, Bloomberg, PAC Research

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



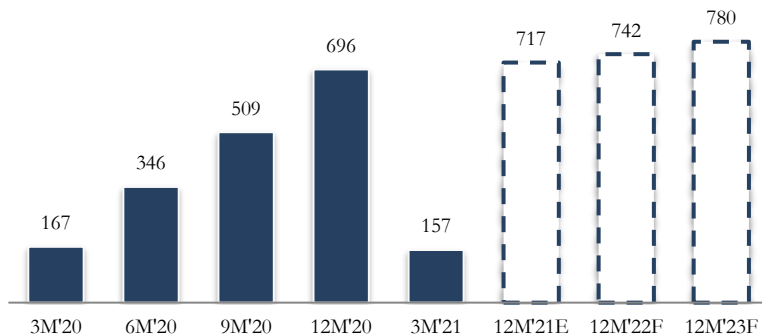
Source: Bloomberg, PAC Research

Gross earnings falls by 5.70% year-on-year, due to lower interest-income:

Zenith Bank managed to improve the top-line through the quarters of 2020, despite the COVID 19 challenge. However, the bank could not replicate the performance in the first quarter of 2021 as gross earnings declined by 5.70% to ₦157.31 billion (vs ₦166.81 billion recorded in first quarter of 2020). The setback in gross earnings could be attributed to the lower interest income recorded during the period. The total interest income of the bank fell by 11.51% to ₦101.18 billion in Q1'21, from ₦114.33 billion reported in the corresponding quarter of previous year. However, the non-interest income line of the bank improved by 9.78% to ₦51.20 billion in Q1'21 (vs. ₦46.64 billion in Q1'20), mainly driven by higher fee and commission income. Going forward, we may likely see improvement in the top-line as we expect the current high yields in the fixed income and money market to have significant impact on the interest income of the bank. In addition, the experience of most people from COVID-19 challenge has reduced physical transactions and we expect this to have positive impact on the fee and commission income of the bank going forward.

The performance of the bank's top-line was mainly driven by the improved interest income and non-interest income during the period.

Fig. 6: Gross Earnings – 3M'20 – 12M'23F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

With prevailing low yield environment in first quarter of 2021, interest

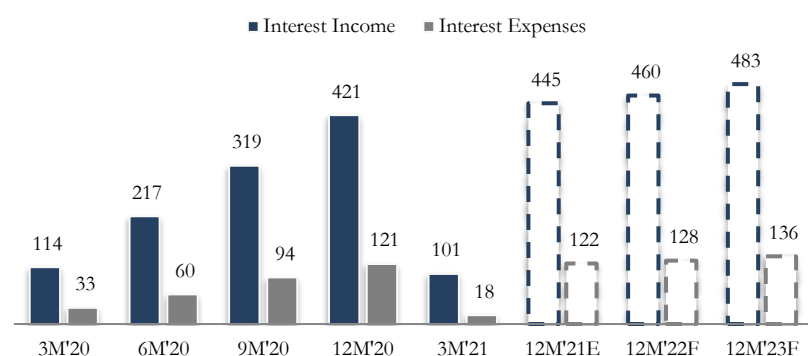
income falls by 11.51%: In the three-month to March 2021, the interest income line of Zenith Bank declined by 11.51% to ₦18.01 billion in Q1'21 (vs. ₦32.83 billion in Q1'20), due to the prevailing low yield environment in the first quarter of 2021, which affected the yields on marketable securities and the pricing of risk assets. Interest income from treasury bills declined significantly by 33.96% to ₦10.11 billion in Q1'21 (vs. ₦15.31 billion in Q1'20). Also, interest income from loans and advances dropped by 4.25% to ₦64.67 billion in Q1'21 (vs. ₦67.54 billion in Q1'20), despite the higher total loans and advances reported during the period. However, the bank continues to benefit from the long position taken in bonds market when yields were high as total interest income from the government and other bonds increased by 7.75% to ₦22.02 billion in Q1'21 (vs. ₦20.43 billion in Q1'20).

With the recent increase in yields in the fixed income and money market, we may see upward repricing of interest earning assets which may lead to improvement in total interest income of the bank in second quarter of 2021.

Impressively, the bank benefited from the low yield environment in the first quarter of 2021 as cost of funds declined significantly to 1.1%, from 2.6% recorded in the corresponding quarter of previous year. The lower cost of funds translated to reduction of 58.68%, 66.22% and 23.33% in interest and similar expense on saving accounts, time deposit and borrowed funds respectively, notwithstanding significant increase in total deposit during the period. As a result, the total interest and similar expenses declined significantly by 45.15% to ₦18.01 billion in Q1'21 (vs. ₦32.83 billion in Q1'20). Going forward, we may likely see an upward repricing of interest-bearing liabilities due to the recent rising yields across the board, and this may lead to higher interest and similar expenses in the coming quarters.

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Fig. 7: Interest Income and Interest Expenses: 3M'20 – 12M'23F (Billion NGN)



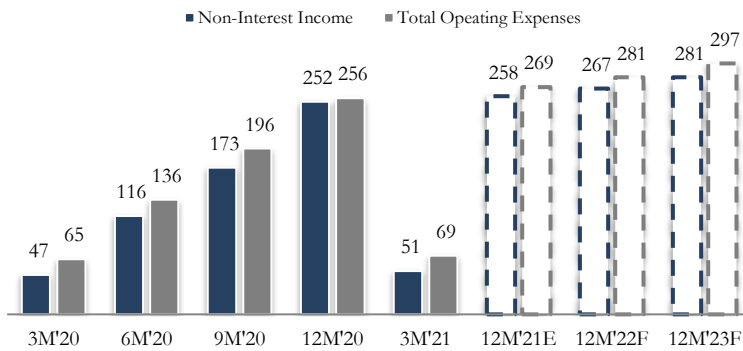
Source: NSE, Bloomberg, PAC Research.

Non-interest income improves by 9.78% year-on-year, driven by the growth recorded in credit related fees & fees on electronic products:

During the period under review, the non-interest income of Zenith Bank rose by 9.78% to ₦51.20 billion (vs. ₦46.64 billion in first quarter of 2020), driven by significant improvement in fee & commission income. The fee & commission income increased by 6.30% to ₦36.35 billion (vs. ₦21.28 billion in first quarter of 2020), due to the growth recorded in credit related fees and fees on electronic products. With increased volume of transactions across all the bank's channels in the first quarter of 2021, credit related fees and fees on electronic products improved by 106.90% and 104.58% to ₦8.07 billion (Q1'20: ₦3.90 billion) and ₦11.13 billion (Q1'20: ₦5.44 billion) respectively. However, trading income fell by 36.34% to ₦9.85 billion in Q1'21 (₦15.47 billion in Q1'20), mainly due to a loss of ₦4.83 billion in bond trading (vs. a loss of ₦0.18 billion in bond trading). With higher traffic on on-line banking, we may likely see improvement in fee & commission income in coming quarters and this will have positive impact on non-interest income of the bank.

The total operating expenses of the bank improved by 6.26% to ₦69.49 billion in Q1'21 (vs. ₦65.40 billion in Q1'20), due to higher personnel expenses, higher AMCON expenses, higher expenses on information technology, among others. Impressively, the 6.96% increase in total operating expenses during the period is 1,191 bps lower than the inflation rate of 18.17% for the month of March 2021.

Fig. 8: Non-Int. Income & Total Op. Expense: 3M'20 – 12M'23F (Billion NGN)

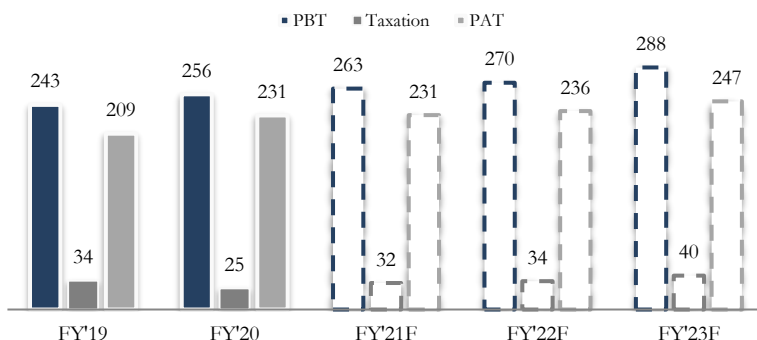


Source: NSE, Company's Results, PAC Research

PAT rises by 3.80% year-on-year due to the optimisation of cost of funds and improvement in non-interest income: Despite the negative impacts of COVID-19 on loans and advances given out during the period, the bank witnessed an improvement in impairment charges as it fell by 2.43% to ₦3.86 billion in the first quarter of 2021 (vs. ₦3.95 billion in first quarter of 2020), and this may be attributed to the effective management of the earning assets.

With the optimisation of cost of funds and improvement in non-interest income, profit before tax increased by 3.80% to ₦61.02 billion in Q1'21 (vs. ₦58.79 billion reported in Q1'20). The bank made a lower provision of ₦7.96 billion for tax during the period (Q1'20: ₦8.26 billion) and as a result, profit after tax improved by 5.02% to ₦53.06 billion in Q1'21 (vs. ₦50.53 billion in Q1'20). Impressively, 12-month trailing EPS improved to ₦7.42, from ₦6.66 recorded in corresponding previous period.

Fig. 9: PBT, Taxation and PAT – FY'19 - FY'23F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

... the 6.96% increase in total operating expenses during the period is 1,191 bps lower than the inflation rate of 18.17% for the month of March 2021.

...the impressive performance of the bank across the board offsets the higher impairment charge during the period as profit before tax increased by 5.17%...

Balance Sheet remains healthy and solid: Expectation of impressive historical interim dividend payment in H1'21: With the strong liquidity ratio and capital adequacy ratio, the balance sheet of the bank remains strong and solid in the first quarter of 2021. The liquidity ratio of the bank was 45.0% in the first quarter of 2021 (vs. 41.8% in first quarter of 2020), and this is well above the regulatory requirement of 30%. In addition, the Capital Adequacy Ratio (CAR) of the bank at 21.1% in Q1'21 (Q1'20: 19.6%) is also above the industry requirement of 15%. However, the bank recorded a loan-to-deposit ratio of 61.7% in Q1'21 (Q1'20: 71.7%), which is below the regulatory minimum requirement of 65.0%, as the bank continued to monitor its loans and advances. This resulted to an improvement in non-performing loan of 4.20% in first quarter of 2021 (vs. 4.60% in first quarter of 2020).

The total assets of the bank increased significantly by 21.81% to ₦8.68 trillion in Q1'21 (vs. ₦7.13 trillion in Q1'20), mainly as a result of improved loans and advances, higher treasury bills and higher cash & balances with central banks. However, the total liabilities of the bank increased significantly by 22.40% to ₦7.59 trillion in Q1'21 (vs. ₦6.20 trillion in Q1'20), mainly due to higher deposits from customers and borrowings. Consequently, net asset increased by 17.92% to ₦1.09 trillion in Q1'21 (vs. ₦0.93 trillion in Q1'20) and this translated to a net asset per share of ₦34.78 (Q1'20: ₦29.49). With the robust balance sheet and expectation of improved performance in the second quarter of 2021, the bank may likely match the interim dividend of ₦0.30 of last year in the half year of 2021.

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Fig. 10: Total Liabilities Vs Net Asset in Q1'21

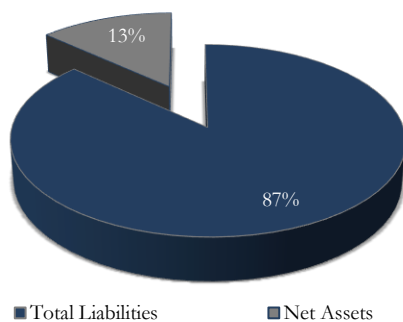
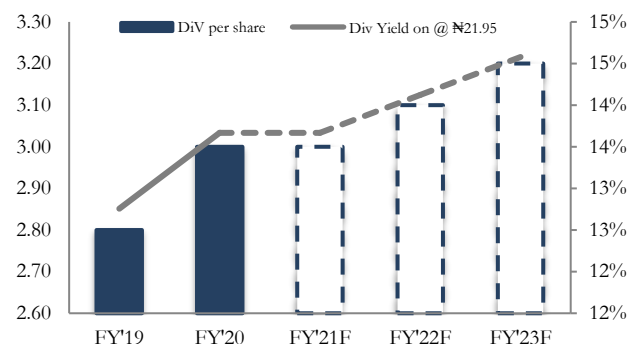


Fig. 11: Dividend Per Share and Dividend Yield (FY'19-FY'23F)



Source: Company's Presentation, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦30.78, representing an increase of 40.23% from the current price of ₦21.95. 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 N30.78, representing an increase of 40.23% from the current price of N21.95.

Fig. 14: Share Price History (Naira)



Source: NSE, PAC Research

Fig. 15: Statement of Profit or Loss, N'mn

	2019	2020	2021F	2022F
Gross Earnings	696,450	717,344	742,451	779,573
Change	10.49%	3.00%	3.50%	5.00%
Interest and Similar Income	420,813	444,753	460,319	483,335
Change	-4.37%	5.69%	3.50%	5.00%
Interest and Similar Expenses	-121,131	-121,948	-127,701	136,425
Change	-16.15%	0.67%	4.72%	6.83%
Net Interest Income	299,682	322,805	332,618	346,910
Change	1.38%	7.72%	3.04%	4.30%
Impairment Charge for credit losses	-39,534	-43,041	-44,547	-38,979
Change	115.19%	8.87%	3.50%	12.50%
Fees and Commission Income	79,332	93,255	96,519	101,344
Change	-3.03%	17.55%	3.50%	5.00%
Trade gains	121,678	136,295	139,581	146,560
Change	51.71%	12.01%	2.41%	5.00%
Personnel expenses	-79,258	-82,136	-85,011	-89,261
Change	15.61%	3.63%	3.50%	5.00%
Profit Before Taxation	255,861	269,004	274,707	291,560
Change	10.43%	5.14%	2.12%	6.14%
Taxation	-25,296	-32,280	-34,338	-40,818
Change	-33.89%	27.61%	6.38%	18.87%
Profit After Taxation	230,565	236,723	240,368	250,742
Change	19.20%	2.67%	1.54%	4.32%

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

	2019	2020	2021F	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	6,091,250	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	8,024,345	8,241,861	8,571,536
Net Assets	1,117,473	1,135,429	1,330,102	1,383,306
Total equity and liabilities	8,481,272	9,159,774	9,571,964	9,954,842

Fig. 17: Profitability Ratio

	2019	2020	2021F	2022F
Return on Equity	20.63%	20.85%	18.07%	18.13%
Return on Assets	2.72%	2.58%	2.51%	2.52%
Net int. income to Rev.	43.03%	45.00%	44.80%	44.50%
PBT margin	36.74%	37.50%	37.00%	37.40%
Net Profit Margin	33.11%	33.00%	32.38%	32.16%
ROCE	4.10%	3.90%	3.97%	4.06%

Fig. 18: Asset Utilisation

	2019	2020	2021F	2022F
Cash/Revenue	228.55%	239.65%	238.51%	236.24%
Revenue to total assets (x)	8.21%	7.83%	7.76%	7.83%
Interest Inc. / Total Assets	4.96%	4.86%	4.81%	4.86%
Other Income/ Total Assets	0.60%	0.31%	0.33%	0.33%
Rev. to total fixed assets	366.22%	349.27%	290.51%	293.30%
fixed asset turnover	27.31%	28.63%	34.42%	34.09%

Fig. 19: Liquidity Ratios

	2019	2020	2021F	2022F
Current ratio	1.15	1.14	1.16	1.16
Cash ratio	0.22	0.21	0.21	0.21
Interest Coverage ratio	2.11	2.21	2.15	2.14
Liquid Assets/Total Deposit	0.78	0.74	0.73	0.73
Loans & Adv./Total Deposit	0.52	0.49	0.52	0.52
Liquid Assets/Total Assets	0.49	0.49	0.48	0.48
Debt/net income	3.96	3.10	3.19	3.18
Debt to asset	0.11	0.08	0.08	0.08
Debt to equity	0.82	0.65	0.58	0.58
Total Liabilities / Total Asset	0.87	0.88	0.86	0.86
Cost to income ratio	0.50	0.50	0.51	0.50
net interest margin AVERAGED	0.07	0.07	0.08	0.08
Total liabilities/equities	6.59	7.07	6.20	6.20

Fig. 20: Shareholders' Investment Ratios

	2019	2020	2021F	2022F
Earnings per share	7.34	7.54	7.66	7.99
DiV per share	3.00	3.00	3.10	3.20
NAVPS	35.59	36.16	42.36	44.06
Earnings yield	33.46%	34.35%	34.88%	36.38%

Fig. 21: Capital Adequacy Ratios

	2019	2020	2021F	2022F
Loans and Advances/Equity	2.49	2.64	2.43	2.43
Equity/Total Assets	0.13	0.12	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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