

Zenith Bank Plc

Strong Growth in Interest Income, Trading Income and Fees on Electronic Products Lift Top-Line by 22%

INVESTMENT SUMMARY

Zenith Bank continued to impress the shareholders with outstanding top-line in the first quarter of 2022 as gross earnings of the bank grew by 21.75% to ₦191.52 billion (vs. ₦157.31 billion in the first quarter of 2021), driven by strong growth in interest income and non-interest income. The total interest income of the bank rose by 24.91% to ₦126.38 billion in Q1'22 (vs. ₦101.78 billion in Q1'21) driven by the growth in risk assets and gradual improvement in pricing. Also, the non-interest income of the bank improved significantly by 11.75% to ₦57.23 billion in Q1'22 (vs. ₦51.20 billion in Q1'21) due to significant increase in electronic banking income and trading income during the period. However, the higher interest rates and growth in customers' deposits in Q1'22 resulted in higher interest and similar expenses, which increased by 24.91% to ₦25.85 billion (vs. ₦18.01 billion in Q1'21). In line with our forecast, the impairment charge increased significantly by 75.33% to ₦6.76 billion in Q1'22 (vs. ₦3.86 billion in Q1'21), because of the growth in loan book during the period.

Meanwhile the operating expenses of the bank grew significantly by 19.47% to ₦83.02 billion in Q1'22 (vs. ₦69.49 billion in Q1'21) driven by higher energy costs, rising inflation and increased regulatory costs (resulting from the growth in the bank's balance sheet). Despite the growth in impairment charge and higher operating expenses during the period, the profit before tax grew by 11.42% to ₦67.99 billion in Q1'22 (vs. ₦61.02 billion in Q1'21). However, the bank made higher provision of ₦9.79 billion for tax in Q1'22 (Q1'21: ₦7.96 billion). Consequently, profit after tax improved by 9.68% to ₦58.20 billion in Q1'22 (vs. ₦53.06 billion in Q1'21), which resulted in a 12-month earnings per share of ₦7.95. Based on the recent figures released by the bank and expectation of improved performance in the coming quarters, 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 ₦32.04 (Previous Target Price: ₦31.49).

Table 1: Quarterly results highlights

	1Q2022	4Q2021	1Q2021	Q/q Δ	Y/y Δ
Gross Earnings (₦mn)	191,523	246,885	157,309	-22.42%	+21.75%
Net Int. Income (₦mn)	100,539	86,058	83,168	+16.83%	+20.89%
Net profit (₦mn)	58,198	83,964	53,060	-30.69%	+9.68%

Source: NGX, Bloomberg, PAC Research

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Price:

- Current	₦24.00
- Target	₦32.04
Recommendation:	STRONG BUY

* As at Tuesday May 24, 2022

Table 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-4.57%/+4.35%
52-week range	₦27.50 - ₦22.00
30-day Average vol.	17,724,249
Shares Outstanding (mn)	31,396.49
Market Cap. (₦bn)	753.52
EPS (₦)	7.95
DPS (₦) - FY2021	3.10

Source: NGX, Bloomberg, PAC Research

Table 3: Key ratios

	Q1'22	Q1'21
Net Interest Margin	7.30%	6.00%
Net profit margin	30.39%	33.73%
Equity multiplier	7.76	7.95
Cash/ total Assets	18.59%	20.32%

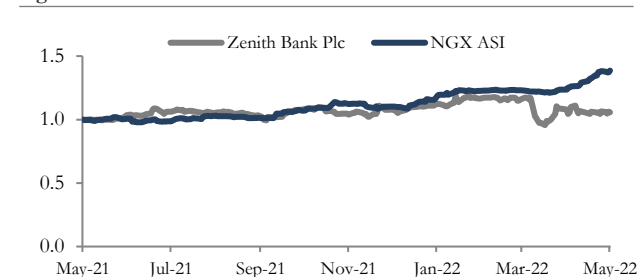
Source: NGX, PAC Research

Tab 4: Valuations

	FY2020	FY2021	FY2022E	FY2023F
P/E (x)	3.27	3.08	2.87	2.51
P/B (x)	0.67	0.59	0.56	0.49
Div Yield	12.50%	12.92%	13.33%	13.75%
Payout Ratio	40.85%	39.80%	38.29%	34.49%
EV/Revenue	1.67	1.20	1.10	1.11
Rev per share	22.18	24.38	25.85	27.14
ROE	20.63%	19.11%	19.67%	19.50%
ROA	2.72%	2.59%	2.40%	2.38%

Source: NGX, PAC Research

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

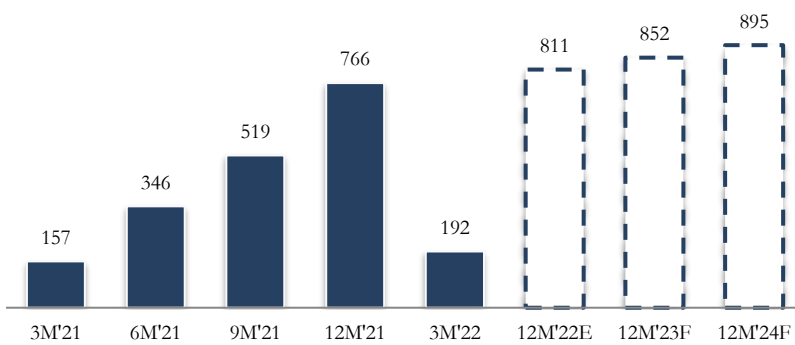


Source: Bloomberg, PAC Research

Gross earnings improve by 21.75% year-on-year, driven by strong growth in interest-income and non-interest income: Zenith Bank started 2022 with impressive performance as the gross earnings of the bank increased significantly by 21.75% to ₦191.52 billion in the first quarter of 2022 (vs. ₦157.31 billion recorded in the first quarter of 2021). The significant improvement in the top-line during the period can be attributed to the improvement recorded in the two major income lines of the bank – interest income and non-interest income. The total interest income of the bank improved by 24.91% to ₦126.38 billion in Q1'22 (vs. ₦101.18 billion achieved in Q1'21). In addition, the non-interest income of the bank grew by 11.78% to ₦57.23 billion in Q1'22 (vs. ₦51.20 billion in Q1'21). The growth in the interest income of the bank was driven by the expansion in risk assets and gradual improvement in pricing during the period. However, the major drivers of the growth recorded in non-interest income during the period are fees on electronic products and trading income.

In the coming quarters, we maintain that the bank will continue to witness improvement in the top-line due to the expectation of improved earnings assets and interest rate. Also, we expect the increased awareness of electronic banking (POS, agency banking, mobile banking, internet banking and ATM transactions) to have positive impact on the total non-interest income of the bank.

Fig. 2: Gross Earnings – 3M'21 – 12M'24F (Billion NGN)



Source: NGX, PAC Research

Interest income rises by 24.91% year-on-year, mainly driven by the growth in risk assets and gradual improvement in pricing: The bank extended the growth recorded in interest income line in the previous quarter to the first quarter of 2022 as it improved significantly by 24.21% to ₦126.38 billion in Q1'22 (vs. ₦101.18 billion in Q1'21). The growth in total interest and similar income of the bank is attributed to the increase in risk assets with gradual improvement in pricing during the period. The increase in risk assets, with gradual improvement in pricing, reflected in interest income from loans and advances to customers which improved by 35.75% to ₦87.78 billion in Q1'22 (vs. ₦64.67 billion in Q1'21).

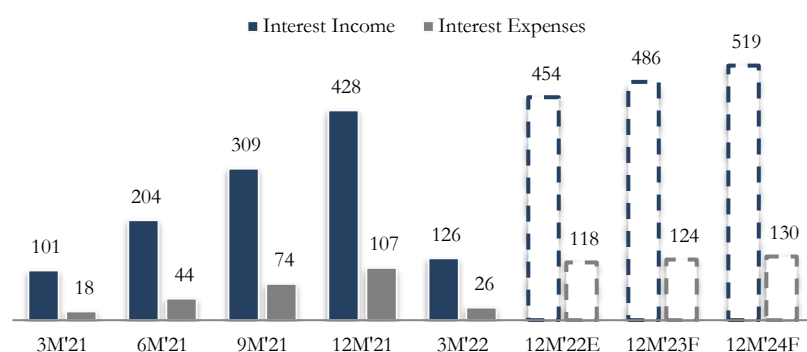
...the bank will continue to witness improvement in the top-line due to the expectation of improved earnings assets and interest rate.

In addition, in Q1'22, the total interest income from treasury bills and bonds (government and others) increased by 11.57% and 21.54% to ₦11.28 billion (Q1'21: ₦10.11 billion) and ₦26.76 billion (Q1'21: ₦22.02 billion), respectively.

Meanwhile, the interest and similar expenses of the bank accelerated by 43.52% to ₦25.85 billion in the first quarter of 2022 (vs. ₦18.01 billion in the first quarter of 2021) due to the progress recorded in total deposit and high cost of funds, which increased by 20 basis points to 1.30% in Q1'22 (Q1'21: 1.10%). Specifically, the total interest and similar expenses on current account, savings accounts and time deposits increased in Q1'22 by 69.74%, 98.66% and 82.48% to ₦4.33 billion (Q1'21: ₦2.55 billion), ₦4.59 billion (Q1'21: ₦2.31 billion), and ₦8.66 billion (Q1'21: ₦4.74 billion), respectively. With the rising interest rates in various countries and higher inflation rate in the country, the Central Bank of Nigeria (CBN) may likely raise Monetary Policy Rate (MPR) in the second quarter of 2021. Hence, we assume incessant increase in interest and similar expenses as we expect banks to adjust the deposit rates upward.

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



Source: NGX, PAC Research,

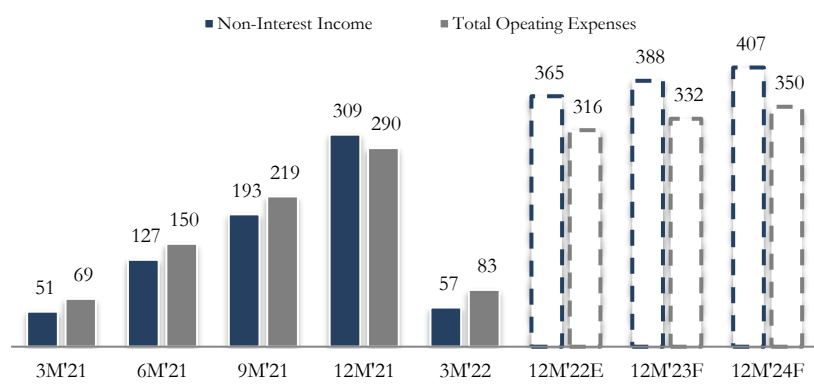
Non-interest income rises by 11.78% year-on-year, driven by higher fees on electronic products and trading income: Zenith bank continued to deploy its retail strategy, thereby acquiring more customers and growing its electronic banking income from the increased volume of transactions across all the channels in the first quarter of 2022. Consequently, the total non-interest income of the bank grew by 11.78% to ₦57.23 billion in Q1'22 (vs. ₦51.20 billion in Q1'21), mainly driven by improvement in trading income and net fee & commission income. The trading income of the bank accelerated by 159.23% to ₦32.60 billion in Q1'22 (vs. ₦12.58 billion in Q1'21), due to the significant increase in treasury bill trading income. Also, the net fee and commission income of the bank improved by 16.71% to ₦33.49 billion in Q1'22 (vs. ₦28.69 billion in Q1'21), mainly driven by notable growth in fees on electronic products, current account maintenance, foreign currency transaction fees and commission, among others.

With increased transactions on different electronic platforms (such as POS, Agency Banking, ATM, mobile and internet banking), the fees on electronic products increased by 32.79% to ₦14.78 billion in Q1'22 (vs. ₦11.13 billion recorded in Q1'21).

However, the total operating expenses of the bank rose by 19.47% to ₦83.02 billion in Q1'22 (vs. ₦69.49 billion in Q1'21), mainly driven by higher energy costs, rising inflation and increased regulatory costs (resulting from the growth in the balance sheet of the bank). This resulted in higher cost-to-income ratio of 55.0% in Q1'22 (Q1'21: 53.2%). Going forward, the bank may continue to witness an 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.

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Fig. 4: Non-Int. Income & Total Op. Expense: 3M'21 – 12M'24F (Billion NGN)

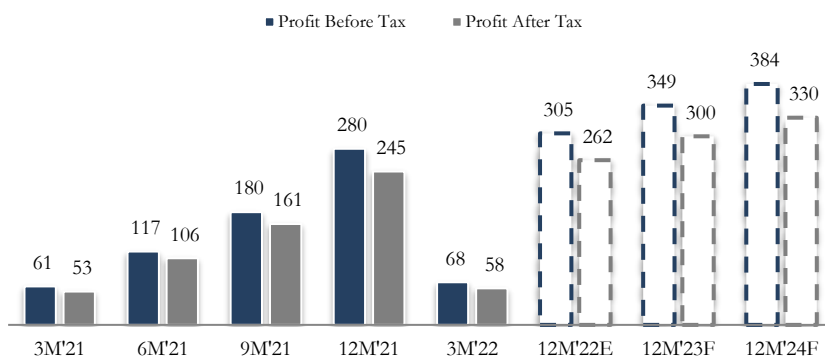


Source: NGX, PAC Research

Profit before tax rises by 11.42% year-on-year, notwithstanding the significant increase in impairment charge: In addition to the higher operating expenses during the period, the bank also recorded a setback in impairment charge as it rose significantly by 75.33% to ₦6.76 billion in Q1'22 (vs. ₦3.86 billion in Q1'21), driven by the expansion in loan book, which led to higher expected credit losses on loans and advances during the period.

Nevertheless, the growth recorded in the two major income lines – interest income and non-interest income – outweighed the setback recorded in operating expenses, interest expenses and impairment charge. As a result, profit before tax improved by 11.42% to ₦67.99 billion in Q1'22 (vs. ₦61.02 billion Q1'21). Meanwhile, the bank made higher provision of ₦9.79 billion for tax in Q1'22 (Q1'21: ₦7.96 billion). Despite the higher tax provision in the first quarter of 2021, profit after tax grew by 9.68% to ₦58.20 billion (vs. ₦53.06 billion in Q1'21), which resulted in a 12-month trailing earnings per share (EPS) of ₦7.95.

Fig. 5: PBT, Taxation and PAT – 3M'21 – 12M'24F (Billion NGN)



Source: NGX, PAC Research

Balance sheet remains strong in Q1'22; expectation of impressive interim dividend in H1'22:

The financial position of Zenith bank remained healthy and strong in the first quarter of 2021 as the total assets of the bank increased by 18.90% to ₦10.32 trillion (vs. ₦8.68 trillion reported in the first quarter of 2021), largely driven by the strong growth in total loans & advances and treasury bills during the period. The total loans and advances grew by 25.03% to ₦3.55 trillion (Q1'21: ₦2.84 trillion) while treasury bills increased by 20.50% to ₦1.76 trillion in Q1'22 (Q1'21: ₦1.57 trillion).

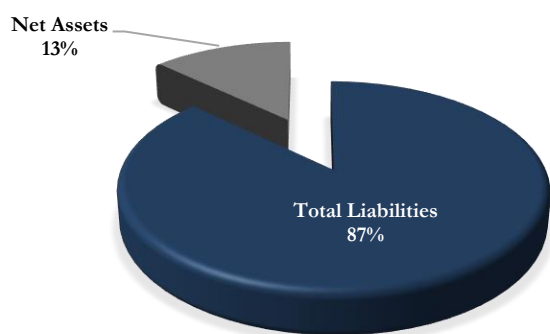
However, the total liabilities of the bank increased by 15.48% to ₦8.99 trillion in Q1'22 (vs. ₦7.59 trillion in Q1'21), mainly due to the higher deposits from customers, which increased by 27.83% to ₦7.25 trillion (Q1'21: ₦5.67 trillion). The growth in the total assets outweighed the increase recorded in the total liabilities during the period. Consequently, the net assets improved by 21.85% to ₦1.33 trillion in Q1'22 (vs. ₦1.09 trillion in Q1'21), which resulted in a net asset per share of ₦42.37 (Q1'21: ₦34.78).

The impressive financial position has positive impacts on the key ratios as Liquidity and Capital Adequacy Ratio (CAR) of the bank are well above the regulatory minimum requirements of 30% and 16%, respectively. Liquidity ratio and Capital Adequacy Ratio (CAR) of the bank increased to 61.3% (Q1'21: 45.0%) and 22.1% (Q1'21: 21.1%) in Q1'22, respectively. In addition, the non-performing loan ratio of the bank increased to 4.22% in Q1'22 (Q1'21: 4.20%), which is below the regulatory maximum requirement of 5.0%. However, the loan-to-deposit ratio of the bank declined to 57.9% in Q1'22 (Q1'21: 61.7%) as the bank continued to monitor its loans closely.

With the current operating performance and robust financial position in the first quarter of 2022 and expectation of impressive financial results in the coming quarters, we expect the bank to maintain its historical interim dividend payment in the half year of 2022.

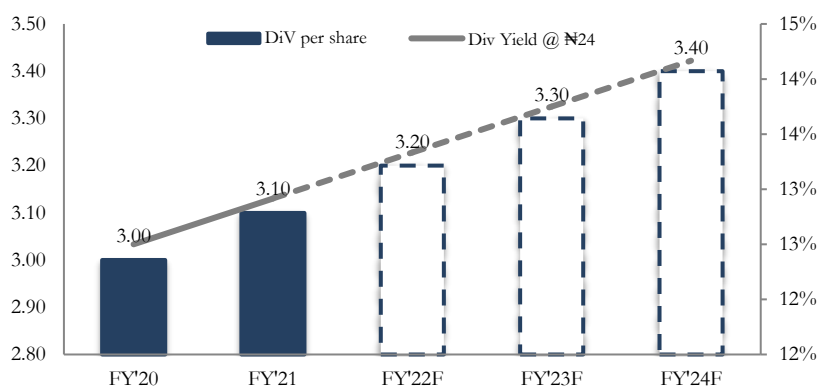
Liquidity ratio and Capital Adequacy Ratio (CAR) of the bank increased to 61.3% (Q1'21: 45.0%) and 22.1% (Q1'21: 21.1%) in Q1'22, respectively.

Fig. 8: Total Liabilities Vs Net Asset in Q1'22



Source: NGX, PAC Research

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



Source: NGX, PAC Research

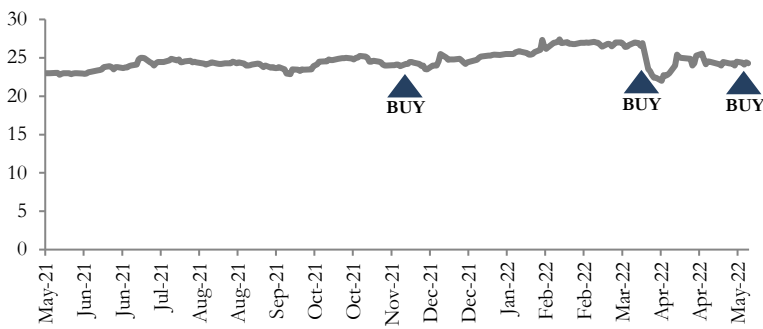
Valuation

Our valuation puts the target price of the stock at ₦32.04, representing an increase of 33.49% from the current price of ₦24.00. 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 banking industry and outlook from the bank’s management.

Our valuation puts the target price of the stock at ₦32.04, representing an increase of 33.49% from the current price of ₦24.00.

Fig. 10: Share Price History (Naira)



Source: NGX, PAC Research

Fig. 11: Statement of Profit or Loss, N'mn

	2020	2021	2022E	2023F
Gross Earnings	696,450	765,558	811,491	852,066
Change	5.16%	9.92%	6.00%	5.00%
Interest and Similar Income	420,813	427,597	454,435	485,678
Change	1.26%	1.61%	6.28%	6.87%
Interest and Similar Expenses	-121,131	-106,793	-117,666	123,550
Change	-18.45%	-11.84%	10.18%	5.00%
Net Interest Income	299,682	320,804	336,769	362,128
Change	12.23%	7.05%	4.98%	7.53%
Impairment Charge for credit losses	-39,534	-59,932	-81,149	-68,165
Change	64.51%	51.60%	35.40%	16.00%
Fees and Commission Income	79,332	103,958	121,724	127,810
Change	-20.75%	31.04%	17.09%	5.00%
Trade gains	121,678	167,483	202,873	213,017
Change	3.29%	37.64%	21.13%	5.00%
Personnel expenses	-79,520	-79,885	-85,207	-89,467
Change	2.13%	0.46%	6.66%	5.00%
Profit Before Taxation	255,861	280,374	305,121	349,347
Change	5.17%	9.58%	8.83%	14.49%
Taxation	-25,296	-35,816	-42,717	-48,909
Change	-26.57%	41.59%	19.27%	14.49%
Profit After Taxation	230,565	244,558	262,404	300,438
Change	10.40%	6.07%	7.30%	14.49%

Fig. 12: Statement of Financial Position, N'mn

	2020	2021	2022E	2023F
Cash and balances	1,591,768	1,488,363	1,658,663	1,890,549
Treasury bills	1,577,875	1,764,945	2,073,329	2,394,695
Assets pledged as collateral	298,530	392,594	436,490	504,146
Due from other banks	810,494	691,244	763,858	882,256
Derivative assets	44,496	56,187	84,024	97,048
Loans and advances	2,779,027	3,355,728	4,040,809	4,667,135
Investment securities	996,916	1,303,726	1,418,594	1,638,476
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	10,912,259	12,603,659
Customer deposits	5,339,911	6,472,054	7,747,704	8,948,598
Derivative Liabilities	11,076	14,674	14,251	16,460
Other liabilities	703,292	487,432	600,174	693,201
On lending facilities	384,573	369,241	381,929	441,128
Borrowings	870,080	750,469	763,858	882,256
Debt securities issued	43,177	45,799	55,553	64,164
Total Liabilities	7,363,800	8,168,181	9,578,509	11,063,178
Net Assets	1,117,472	1,279,662	1,333,749	1,540,481
Total equity and liabilities	8,481,272	9,447,843	10,912,259	12,603,659

Fig. 13: Profitability Ratio

	2020	2021	2022E	2023F
Return on Equity	20.63%	19.11%	19.67%	19.50%
Return on Assets	2.72%	2.59%	2.40%	2.38%
Net int. income to Rev.	43.03%	41.90%	41.50%	42.50%
PBT margin	36.74%	36.62%	37.60%	41.00%
Net Profit Margin	33.11%	31.95%	32.34%	35.26%
ROCE	4.10%	4.07%	3.70%	3.67%

Fig. 14: Asset Utilisation

	2020	2021	2022E	2023F
Cash/Revenue	228.55%	194.42%	204.40%	221.88%
Revenue to total assets (x)	8.21%	8.10%	7.44%	6.76%
Interest Inc. / Total Assets	4.96%	4.53%	4.16%	3.85%
Other Income/ Total Assets	0.60%	0.40%	0.37%	0.37%
Rev. to total fixed assets	366.22%	382.76%	331.66%	301.51%
fixed asset turnover	27.31%	26.13%	30.15%	33.17%

Fig. 15: 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	2.59	2.83
Liquid Assets/Total Deposit	0.78	0.70	0.66	0.66
Loans & Adv./Total Deposit	0.52	0.52	0.52	0.52
Liquid Assets/Total Assets	0.49	0.48	0.47	0.47
Debt/net income	3.96	3.26	3.12	3.15
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 net interest margin AVERAGED	0.50	0.51	0.51	0.49
Total liabilities/equities	6.59	6.38	7.18	7.18

Fig. 16: Shareholders' Investment Ratios

	2020	2021	2022E	2023F
Earnings per share	7.34	7.79	8.36	9.57
DiV per share	3.00	3.10	3.20	3.30
NAVPS	35.59	40.76	42.48	49.07
Earnings yield	30.60%	32.46%	34.82%	39.87%

Fig. 17: Capital Adequacy Ratios

	2020	2021	2022E	2023F
Loans and Advances/Equity	2.49	2.62	3.03	3.03
Equity/Total Assets	0.13	0.14	0.12	0.12
Loan Loss Expense/ Equity	0.04	0.05	0.06	0.04

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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