Zenith Bank Plc

Nigeria | Equities | Financial Services | March 26, 2018 — PAC RESEARCH

Earnings Soar as Trading Gains Surge

Oluwole Adeyeye
oluwole.samuel@panafricancapitalplc.com

Price:	
- Current	**₦30.20**
- Target	**₦36.59**
Recommendation:	**BUY**

** As at Friday March 23, 2018*

INVESTMENT SUMMARY

The recent FY'17 audited accounts released by Zenith Bank Plc shows a growth of 46.69% in its gross earnings as it increased to ₦745.19 billion in FY'17 (vs. ₦507.56 billion in FY'16). The growth was majorly boosted by trading gains from investment in derivative, treasury bill and bond. Trading gains increased by 456.29% to ₦157.97 billion in FY'17 (vs. ₦28.40 billion in FY'16) and this represent 21.20% of gross earning (vs. 5.59% recorded in FY'16). Resulting from high yielding environment in 2017, net interest income increased from ₦240.18 billion in FY'16 to ₦257.99 billion in FY'17, representing an increase of 7.42%. Fee and commission income increased by 31.70% to ₦90.14 billion in FY'17 (vs. ₦68.44 recorded in FY'17), majorly triggered by account maintenance fee and credit related fee. However, impairment charge on financial assets for the period remains a major concern as it grew by 203.64% to ₦98.23 billion in FY'17 (vs. ₦32.35 billion in FY'16). The company was able to grow its customer deposits by 15.23% to ₦3.44 trillion in FY'17 from ₦2.89 trillion in FY'16 while loans and advances reduced from ₦2.29 trillion in FY'16 to ₦2.10 trillion in FY'17, representing a decrease of 8.26%.

On the back of tremendous increase in trading gains, profit before tax increased by 29.80% to ₦203.46 billion in FY'17 (vs. ₦156.75 billion recorded in FY'16) while profit after tax increased to ₦177.93 billion in FY'17 from ₦129.65 billion in FY'16, representing an increase of 37.24%. The bank rewarded the shareholders as it declared a final dividend of ₦2.45 in FY'17 (vs ₦1.77 in FY'16). In addition to the interim dividend of ₦0.25 paid in 2017 (vs ₦0.25 in 2016), the total dividend increased by 33.66% to ₦2.70 FY'17 from ₦2.02 recorded in FY'16.

Based on the recent performance of the company, we recommend a **BUY** on the company shares at current price as present forward estimates places the company share price at ₦36.59

Fig. 1: Quarterly results highlights

	4Q2017	3Q2017	4Q2016	Q/q Δ	Y/y Δ
Gross Earnings (₦'mn)	213,923	150,826	127,645	+41.83%	+67.59%
Net Int. Income (₦'mn)	56,499	62,530	50,362	-9.64%	+12.19%
Net profit (₦'mn)	48,698	53,918	34,266	-9.68%	+42.12%

Source: NSE, PAC Research

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+17.78%/+122.06%
52-week range	₦13.40 - ₦34.20
30-day Average vol.	35,901,370
Shares Outstanding ('mn)	31,396.49
Market Cap. (₦bn)	948.17
EPS (₦) - 12months trailing	5.67
DPS (₦) - FY2017	2.70

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	FY'17	FY'16
Net Interest Margin	47.28%	34.62%
Net profit margin	25.52%	23.88%
Equity multiplier	6.73x	6.81x
Cash/ total Assets	14.12%	17.12%

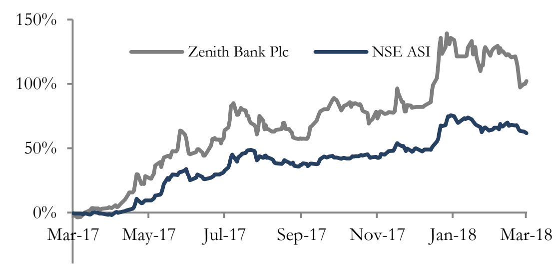
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2016	FY2017	FY2018F	FY2019F
P/E	7.31x	5.33x	5.17x	4.85x
P/B	1.35x	1.15x	1.03x	1.11x
Div Yield (%)	6.69	8.94	9.44	10.10
Payout Ratio	48.92%	47.64%	48.79%	48.99%
Ev/Revenue	2.47%	1.74%	1.66%	1.52%
Rev per share	16.18%	23.74%	27.53%	31.66%
ROE	18.40%	21.66%	19.87%	22.87%
ROA	2.74%	3.18%	2.88%	2.85%

Source: NSE, PAC Research

Fig. 5: ZENITH vs NSE, 52-wk Movement (Rebased)

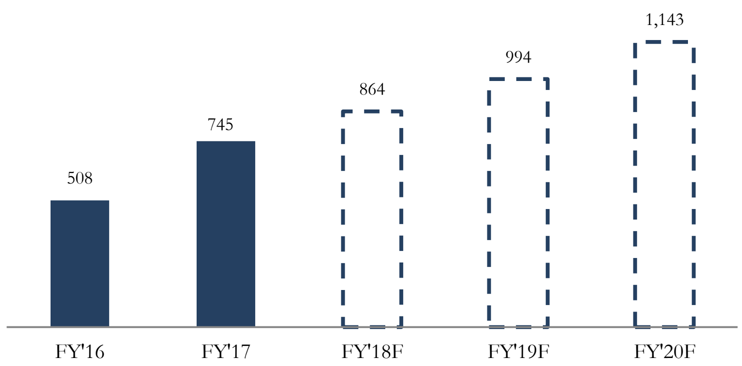


Source: Bloomberg, PAC Research

Gross earnings increased by 46.69% YoY, boosted by non-interest income: Over the years, Zenith bank has continued to post significant YoY growth in gross earnings. Gross earnings in FY'17 increased by 46.69% to ₦745.19 billion (vs ₦508.00 billion in FY'16) and this was majorly triggered by non-interest income as it grew by 119% to ₦270.56 billion in FY'17 (vs. ₦123.44 billion recorded in FY'16). The growth in non-interest income was enhanced by investments in derivatives and T-bills. T-bills trading income grew by 928% to ₦88.90 billion in FY'17 (vs. ₦8.65 billion in FY'16) while derivative income increased to ₦68.71 billion in FY'17 from ₦20.08 billion in FY'16 representing an increase of 242%. The growth in T-bills was attributed to the high yielding environment in 2017 as the bank hugely benefited from this. Interest income grew to ₦474.63 billion in FY'17 from ₦384.56 billion in FY'16, representing a growth of 23.42% YoY. However, interest income continue to contribute more to the gross earnings as it contributed 63.69% in FY'17 (vs. 75.70% in FY'16) while non-interest income contributed 36.31% to gross earnings in FY'17 (vs. 24.30% in FY'16).

Gross earnings in FY'17 increased by 46.69% to ₦745.19 billion (vs ₦508.00 billion in FY'16) and this was majorly triggered by non-interest income as it grew by 119% to ₦270.56 billion in FY'17…

Fig. 6: Grosss Earnings - FY'16-FY'20F (Billion NGN)



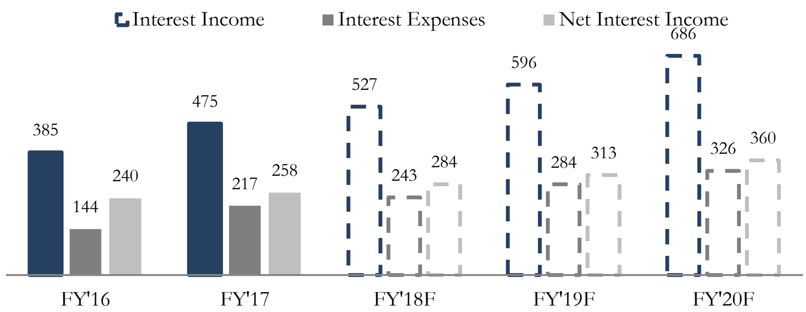
Source: NSE, PAC Research

Interest income continues to impress but interest expenses surge: In full year 2017, interest income grew by 23.42% to ₦474.63 billion (vs. ₦384.56 billion in FY'16). The growth in interest income can be attributed to the interest income from loans and advances and treasury bills as they contributed 66.30% and 23.12% respectively to the total interest income. Interest income from loans and advances increased by 15.12% to ₦314.68 billion in FY'17 (vs. ₦273.35 billion in FY'16) while interest income from treasury bills increased from ₦60.19 billion in FY'16 to ₦109.74 billion in FY'17 and this represents an increase of 82.33%. However, interest expenses increased by 50.05% to ₦216.64 billion in FY'17 (vs. ₦144.38 billion in FY'16) due to the tight monetary environment and additional $500 million Eurobond issued in 2017. Interest expenses of ₦108.74 billion in FY'17 on time deposit accounted for 50.19% of the total interest expenses, closely followed by interest expenses on borrowed funds (FY17: ₦80.77 billion) which accounted for 37.3% of total interest expenses.

The growth in interest income can be attributed to the interest income from loans and advances and treasury bills as they contributed 66.30% and 23.12% respectively to the total interest income.

Interest expenses on savings accounts (FY'17: ₦17.10 billion) and expenses on current accounts (FY17: ₦10.03 billion) contributed 7.9% and 4.6% respectively to the total interest expenses. Net interest income increased by 7.42% to ₦258.00 billion in FY'17 (vs. ₦240.18 billion in FY'16)

Fig. 7: Int. Income, Int. Expenses and Net Int. Income: FY'16-FY'20F (Billion NGN)



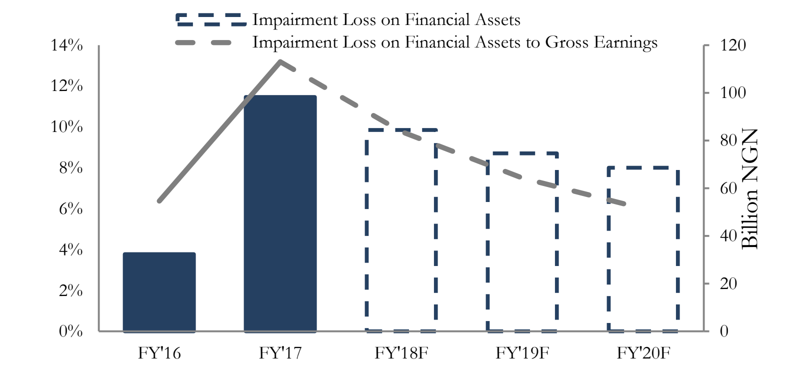
Source: NSE, PAC Research

Impairment loss on financial assets soared as non-performing loan increased:

There is an increase in loan impairment charge for FY'17 as bank makes adequate provision: In recent years, banks have significantly suffered enormous losses arising from bad loans and this forced most banks to make adequate provisions for non-performing loans. As a result, the company's impairment charges for financial assets increased by 203.64% to ₦98.23 billion in FY'17 (vs. ₦32.35 billion in FY'16). Term loan of ₦65.91 billion in FY'17 (FY'16: ₦19.10 billion) accounted for 67.09% of the impairment loss while overdraft of ₦31.31 billion in FY'17 (FY'16: ₦13.79 billion) accounted for 31.87%. Though the company was able to monitor its loans and advances to the customers as it reduced it by 4.60% to ₦2.25 trillion in FY'17 (vs. ₦2.36 trillion in FY'16) the non-performing loans continued to increase. NPL increased from ₦71.37 billion in FY'16 to ₦105.87 billion in FY'17, representing an increase of 48.34%. Of the total loans to the customers in FY'17, upstream oil and gas accounted for 16.38%, closely followed by government (13.85%) and downstream oil and gas (12.93%).

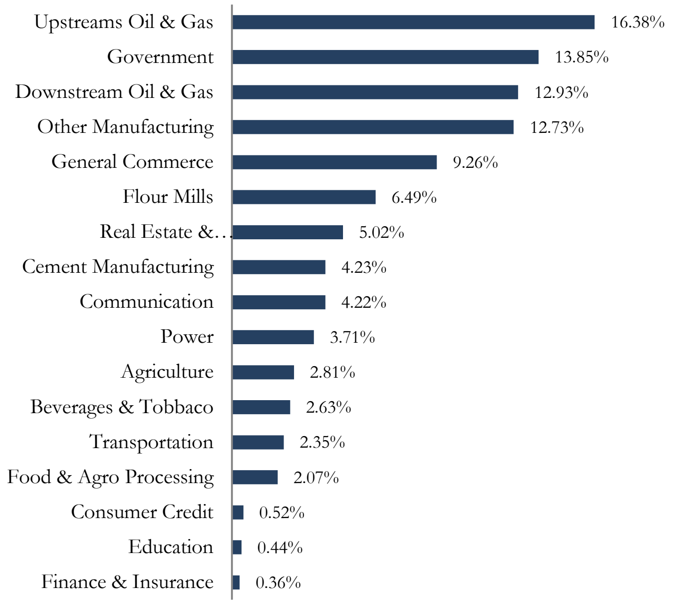
Though the company was able to monitor its loans and advances to the customers as it reduced it by 4.60% to ₦2.25 trillion in FY'17 (vs. ₦2.36 trillion in FY'16) the non-performing loans continued to increase.

Fig. 8: Impairment Loss on Financial Assets to Gross Earnings (FY'16-FY'20F)



Source: NSE, PAC Research

Fig. 9: Loan by Sectors - 2017

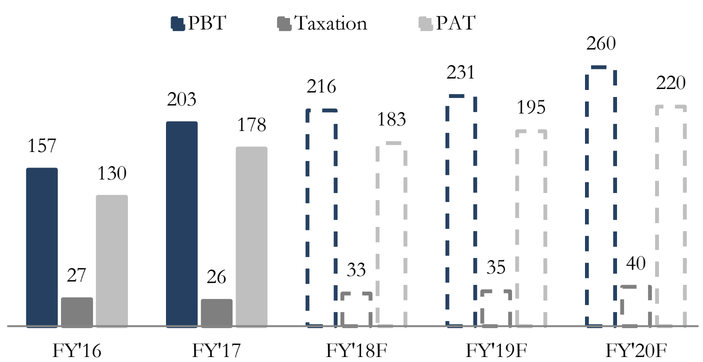


Source: NSE, PAC Research, Zenith's Presentation

Trading gains support profits as bottom line grows by 37.24% YoY: Impairment loss on financial assets almost pose a threat to the profit of the company as it grew by 203.64% to ₦98.23 billion in FY'17 (vs. ₦32.35 billion in FY'16). However, trading gains offset the effect of impairment charge on the profit of the company as it grew by 456.29% to ₦157.97 billion in FY'17 (vs. ₦28.40 billion in FY'16) and as a result, PBT grew from ₦156.75 billion in FY'16 to ₦203.46 billion in FY'17, representing an increase of 29.80%. The provision for tax reduced by 5.79% to ₦25.53 billion in FY'17 (vs. ₦27.10 billion paid in FY'16) and as a result PAT surged to ₦177.93 billion in FY'17 from ₦129.65 billion recorded in FY'16, representing an increase of 37.24%.

…trading gains offset the effect of impairment charge on the profit of the company as it grew by 456.29% to ₦157.97 billion in FY'17 (vs. ₦28.40 billion in FY'16)…

Fig. 10: Profit before Tax, Taxation and Profit after Tax (FY'16-FY'20F) (Billion NGN)



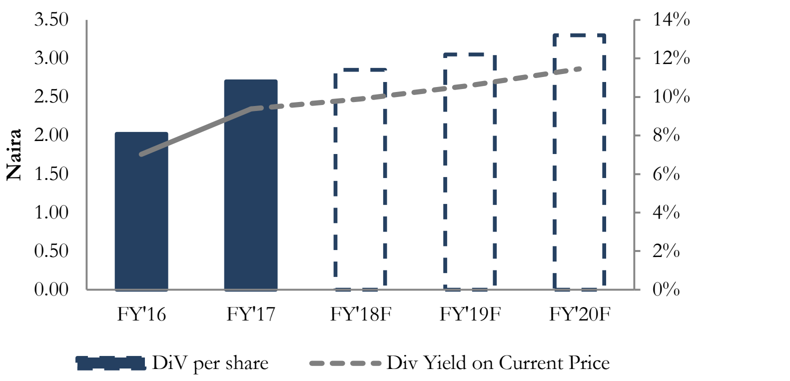
Source: NSE, PAC Research

Solid and high quality capital position of the bank gives room for improved dividends:

Recently, the Central Bank of Nigeria has stopped the payment of dividends to shareholders by Deposit Money Banks and discount houses with huge bad loans and low capital base. As of September 2017, the banking industry's NPLs had hit 15.18 per cent. As a result, the CBN's minimum NPL threshold for banks is 5%, that is, lenders' bad loans should not exceed 5% of their loan books. Zenith's NPL ratio grew from 3.0% in FY'16 to 4.7% in FY'17 and this is below the minimum ratio of 5% dictated by the CBN. Also, Liquidity and Capital Adequacy Ratio of the bank are well above industry requirements of 30% for liquidity and 15% for capital adequacy ratio. Liquidity and capital adequacy ratio of the bank in FY'17 are 70% (FY'16: 60%) and 27% (FY'16: 23%) respectively. During the period, the company also increased its net asset by 16.64% from ₦704.47 billion in FY'16 to ₦821.66 billion in FY'17 as the NAPS increased by 16.64% to ₦26.17 in FY'17 (vs ₦22.44 in FY'16). As a result the bank paid dividend of ₦2.70 per share in FY'17, higher by 34% of ₦2.02 dividend per share paid in FY'16.

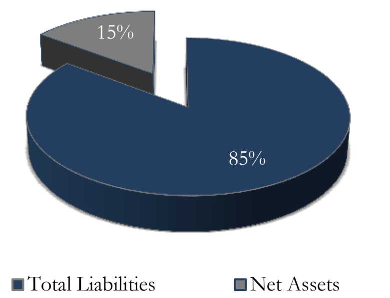
Liquidity and capital adequacy ratio of the bank are well above industry requirements of 30% for liquidity and 15% for capital adequacy ratio. Liquidity and capital adequacy ratio of the bank in FY'17 are 70% (FY'16: 60%) and 27% (FY'16: 23%) respectively.

Fig. 11: Dividend Per Share and Dividend Yield (FY'16-FY'20F)



Source: NSE, PAC Research

Fig. 12: Total Liabilities Vs Net Asset in FY'17



Source: NSE, PAC Research

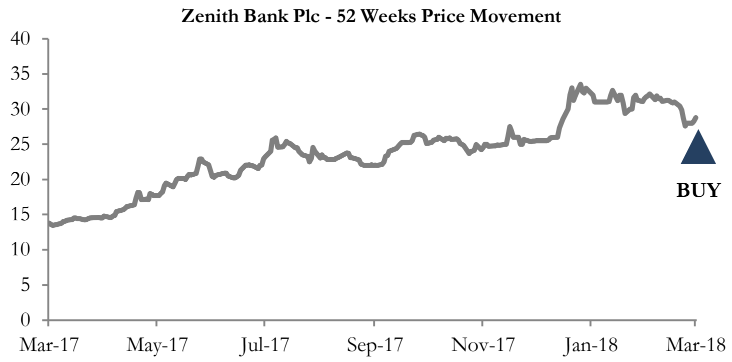
Valuation

Our valuation puts the target price of the stock at ₦36.59 representing an increase of 21.16% from the current price of ₦30.20. In arriving at the target price, we employed Discounted Cashflow Valuation methodology, Dividend Discount Model, Residual Income Model. Consequently, we maintained 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 bright outlook from the management.

Our valuation puts the target price of the stock at ₦36.59 representing an increase of 21.16% from the current price of ₦30.20

Fig. 13: Share Price History



Source: NSE, PAC Research

Fig. 14: Statement of Profit or Loss, N'mn

	2016	*2017*	*2018F*	*2019F*
Gross Earnings	507,997	745,189	864,419	994,082
Change		*46.69%*	*16.00%*	*15.00%*
Interest & Similar Income	384,557	474,628	527,296	596,449
Change		*23.42%*	*11.10%*	*13.11%*
Interest & Similar Expenses	*-144,378*	*-216,637*	*-243,248*	*-283,810*
Change		*50.05%*	*12.28%*	*16.68%*
Net Interest Income	240,179	257,991	284,048	312,639
Change		*7.42%*	*10.10%*	*10.07%*
Impairment Charge	-32,350	-98,227	-84,454	-74,556
Change		*203.64%*	*-14.02%*	*-11.72%*
Fees & Comm. Income	68,444	90,143	99,408	107,361
Change		*31.70%*	*10.28%*	*8.00%*
Trade gains	28,398	157,974	155,595	159,053
Change		*456.29%*	*-1.51%*	*2.22%*
Personnel expenses	-59,326	-64,459	-74,772	-85,988
Change		*8.65%*	*16.00%*	*15.00%*
Profit Before Taxation	156,748	203,461	216,364	230,627
Change		*29.80%*	*6.34%*	*6.59%*
Taxation	-27,096	-25,528	-32,974	-35,148
Change		*-5.79%*	*29.17%*	*6.59%*
Profit After Taxation	129,652	177,933	183,390	195,479
Change		*37.24%*	*3.07%*	*6.59%*

Fig. 15: Statement of Financial Position, N'mn

	2016	2017	2018F	2019F
Cash and balances	669,058	957,663	1,126,165	1,282,366
Treasury bills	557,359	936,817	1,017,594	944,378
Assets pledged as collateral	328,343	468,010	543,806	596,449
Due from other banks	459,457	495,803	561,873	646,153
Derivative assets	82,860	57,219	40,195	46,225
Loans and advances	2,289,365	2,100,362	2,420,374	2,584,614
Investment securities	199,478	330,951	388,989	447,337
Deferred tax assets	6,440	9,561	11,237	12,923
Other assets	37,536	92,494	85,578	99,408
Property and equipment	105,284	133,384	159,918	183,905
Total Assets	4,739,825	5,595,253	6,371,288	6,862,149
Customer deposits	2,983,621	3,437,915	3,803,445	4,125,441
Derivative Liabilities	66,834	20,805	24,117	27,735
current income tax liabilities	8,953	8,915	8,644	9,941
Other liabilities	208,680	233,481	345,768	397,633
On lending facilities	350,657	383,034	432,210	526,864
Borrowings	263,106	356,496	410,599	422,485
Debt securities issued	153,464	332,931	423,565	497,041
Total Liabilities	4,035,360	4,773,595	5,448,434	6,007,238
Net Assets	704,465	821,658	922,854	854,911
Total equity and liabilities	4,739,825	5,595,253	6,371,288	6,862,149

Fig. 16: Profitability Ratio

	2016	2017	2018F	2019F
Return on Equity	18.40%	21.66%	19.87%	22.87%
Return on Assets	2.74%	3.18%	2.88%	2.85%
Net int. income to Rev.	47.28%	34.62%	32.86%	31.45%
PBT margin	30.86%	27.30%	25.03%	23.20%
Net Profit Margin	25.52%	23.88%	21.22%	19.66%
ROCE	4.71%	5.15%	4.78%	4.48%

Fig. 17: Asset Utilisation

	2016	2017	2018F	2019F
Cash/Revenue	131.71%	128.51%	130.28%	129.00%
Revenue to total assets (x)	10.72%	13.32%	13.57%	14.49%
Interest Inc. / Total Assets	8.11%	8.48%	8.28%	8.69%
Other Inc./ Total Assets	0.56%	0.40%	0.41%	0.44%
Revenue to total fixed assets	482.50%	558.68%	540.54%	540.54%
fixed asset turnover	20.73%	17.90%	18.50%	18.50%

Fig. 18: Liquidity Ratios

	2016	2017	2018F	2019F
Current ratio	1.17	1.17	1.17	1.14
Cash ratio	0.17	0.20	0.21	0.21
Interest Coverage ratio	1.09	0.94	0.89	0.81
Liquid Assets/Total Deposit	0.48	0.65	0.67	0.65
Loans &Advances/Total Deposit	0.77	0.61	0.64	0.63
Liquid Assets/Total Assets	0.30	0.40	0.40	0.39
Debt/net income	3.21	3.87	4.55	4.70
Debt to asset	0.09	0.12	0.13	0.13
Debt to equity	0.59	0.84	0.90	1.08
Total Liabilities / Total Asset	0.85	0.85	0.86	0.88
Cost to income ratio	0.53	0.53	0.55	0.57
net interest margin AVERAGED	0.08	0.08	0.08	0.08
Total liabilities/equities	5.73	5.81	5.90	7.03

Fig. 19: Shareholders' Investment Ratios

	2016	2017	2018F	2019F
Earnings per share (₦)	4.13	5.67	5.84	6.23
DiV per share(₦)	2.02	2.70	2.85	3.05
NAVPS (₦)	22.44	26.17	29.39	27.23
Earnings yield (%)	13.67	18.77	19.34	20.62

Fig. 20: Capital Adequacy Ratios

	2016	2017	2018F	2019F
Loans & Advances/Equity	3.25	2.56	2.62	3.02
Equity/Total Assets	0.15	0.15	0.14	0.12
Loan Loss Expense/ Equity	0.05	0.12	0.09	0.09

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

This research report has been prepared by the analyst(s), whose name(s) appear on the front page of this document, to provide background information about the issues which are the subject matter of this report. It is given for information purposes only.

Each analyst hereby certifies that with respect to the issues discussed herein, all the views expressed in this document are his or her own and reflect his or her personal views about any and all of such matters. These views are not necessarily held or shared by PanAfrican Capital or any of its affiliate companies. The analyst(s) views herein are expressed in good faith and every effort has been made to base our opinion on reliable comprehensive information but no representation is made as to its accuracy or completeness. The opinions and information contained in this report are subject to change and neither the analysts nor PanAfrican Capital is under any obligation to notify you or make public any announcement with respect to such change.

This report is produced independently of PanAfrican Capital and the recommendations (if any), forecasts, opinions, estimates, expectations and views contained herein are entirely those of the analysts. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the recommendations, forecasts, opinions, estimates, expectations and views contained herein are fair and reasonable, none of the analysts, PanAfrican Capital nor any of its directors, officers or employees has verified the contents hereof and accordingly, none of the analysts, PanAfrican Capital nor any of its respective directors, officers or employees, shall be in any way responsible for the contents hereof.

With the exception of information regarding PanAfrican Capital, reports prepared by PanAfrican Capital analysts are based on public information. Facts and views presented in this report have not been reviewed and may not reflect information known to professionals on other PanAfrican Capital business areas including investment banking. This report does not provide individually tailored investment advice. Reports are prepared without regard to individual financial circumstances and objectives of persons who receive it. The securities discussed in this report may not be suitable for all investors. It is recommended that investors independently evaluate particular investments and strategies. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances or objectives. Neither the analyst(s), PanAfrican Capital, any of its respective directors, officers nor employees accepts any liability whatsoever for any loss so ever arising from any use of this report or its contents or otherwise arising in connection therewith. Each analyst and/or any person connected with any analyst may have acted upon or used the information herein contained, or the research or analysis on which it is based prior to its publication date. This document may not be relied upon by any of its recipients or any other person in making investment decisions.

Each research analyst certifies that no part of his or her compensation was, or will be directly or indirectly related to the specific recommendations (if any), opinions, forecasts, estimates or views in this report. Analysts" compensation is based upon activities and services intended to benefit clients of PanAfrican Capital. As with other employees of PanAfrican Capital, analysts' compensation is impacted by the overall profitability of PanAfrican Capital, which includes revenues from all business areas of PanAfrican Capital.

PanAfrican Capital Holdings Ltd
8A, Elsie Femi Pearse Street
Victoria Island
Lagos, Nigeria
Tel: +234 (1) 2716899, 2718630
www.panafricancapitalplc.com