

Price	₦23.95
FVE (last communicated)	₦35.25
52-week range	₦22.00 – ₦34.20
Market Cap. (₦'mn)	751,946
1-month Avg. Vol	25,535,460
Curr. P/B	1.02x

ZENITHBA:NL - Share Price Trend



Analyst(s)

Kayode Omosebi
kayode.omosebi@arm.com.ng

Zenith Bank Plc. (ZENITHBA.NL)

Initial View

The light at the end of the tunnel?

- Audited half-year 2018 result of Zenith Bank Plc. (Zenith)** was in line with our expectation as EPS of ₦2.60 (+8.5% YoY) was driven by an ample decline in funding cost and impairment charge which largely offset the pressure from asset yields and lower non-interest revenue (NIR). The bank proposed an interim dividend of ₦0.30 (H1 2017: ₦0.25).
- Lower funding cost lifted by term deposit.** In sync with our views, the lower yield environment provided the bank a break to reprice its deposit base, particularly term deposit which constitutes ~32% of total deposit. Consequently, interest expense contracted 39.4% YoY to ₦74.7 billion with annualized fund cost (WACF) down 297bps to 3.3%. The decline largely reflected a 75% YoY decline in interest expense on term deposit which largely offset interest on borrowings which was up 95% YoY—mirroring 14% increase in borrowings and FX impact on dollar debt.
- Significant improvement in asset quality.** Over the period, non-performing loan (NPL) declined to ₦103 billion (-3% YTD) which largely reflected possible reclassification of a key transport loan, with NPL to transport sector declining 77% YTD. Elsewhere, NPL in the general commerce and manufacturing sectors recorded YTD decline of 9% and 4% accordingly, while Oil & Gas NPL expanded by 18.7% YTD. However, due to contraction in loan book (-11% YTD), NPL ratio increased by 20bps to 4.9%. Thus, impairment charge declined 77% YoY to ₦9.7 billion (impairment on loans at ₦8.3 billion) with annualized Cost of Risk (CoR) moderating 360bps YoY to 1.0%.

- ***Contracting Asset Yields.*** In terms of negative, interest income declined 12.8% YoY to ₦228 billion mirroring decline in interest income on loans (-18% YoY) and Investment securities (-13% YoY) with asset yields contracting 244bps to 10.6%. Irrespective, reflecting the faster decline in funding cost, Net Interest Margin (NIMs) expanded by 23bps to 7.2%.
- ***FX losses impacts NIR.*** Similarly, non-interest revenue declined 20% YoY to ₦95.3 billion on the back of ₦18.6 billion FX losses—reflecting mark-to-market on its derivative position—which drove trading income lower by 44% YoY to ₦37 billion. That said, treasury bills trading income expanded 193% YoY to ₦55.1 billion while fee income expanded 24% YoY on the back of expansion in E-banking income to ₦10.1 billion (H2 17: ₦5.4 billion). Thus, due to lower income, cost-to-income ratio (CIR) expanded 5.03pps to 52.7%
- ***Q2 earnings negatively impacted by NIMs and impairment.*** In the second quarter 2018 alone, the bank reported EPS of ₦1.10 (-26% YoY) due to lower NIMs and impairment charge. For context, reflecting lower asset yields of 6.9% (-386bps QoQ) which more than trump lower funding cost (-149bps to 2.6%), NIMs contracted 294bps to 5.7%. Elsewhere, impairment charge expanded 12.6% QoQ to ₦5.147 billion over the quarter, which to our minds reflects higher NPL in the Oil & Gas sector. However, with ₦55 billion in treasury bills trading income over the quarter, NIR jumped 152% YoY to ₦66.96, despite ₦19.6 billion FX losses over the period.
- Overall, Zenith Bank's result was in line with expectation and in sync with our views on a positive finish for FY 18E, reflecting lower impairment charge and funding cost, while the bank continues to leverage on its derivative position to drive the NIR leg. That said, the sustainability of earnings beyond 2018 remains a concern. We will be seeking clarity from management on loan growth guidance, rising NPL to Oil & Gas, funding cost, derivative position, e-banking income, borrowings and deposit picture.
- Our last communicated FVE on Zenith Bank is ₦35.25 which translates to a **STRONG BUY** rating on the stock. We will revisit our numbers after further analysis and discussion with management.
- The bank will be holding a teleconference call Today August 7, 2018 at 2pm Lagos Time (2pm London/ 3pm Johannesburg/ 9am New York) with its senior management. Click [here](#) for conference call details.

Summary of Results and Forecast

₹'million	H1 2018	H1 2017	YoY (pps)	Q2 18	Q1 18	QoQ
Gross Earnings	285,394	315,122	-9.4%	117,914	167,480	-29.6%
Net Interest Income	153,961	138,962	10.8%	58,063	95,898	-39.5%
Non-Interest Revenue	93,531	118,183	-20.9%	66,957	26,574	152.0%
Operating Expenses	(130,414)	(122,564)	6.4%	(66,516)	(63,898)	4.1%
Impairment	(9,720)	(42,398)	-77.1%	(5,147)	(4,573)	12.6%
PBT	107,358	92,183	16.5%	53,357	54,001	-1.2%
PAT	81,737	75,317	8.5%	34,658	47,079	-26.4%
EPS	2.60	2.40	8.5%	1.10	1.50	-26.4%
₹'million	Q2 2018	Q1 2018	QoQ			
Loans	1,873,173	1,757,011	6.6%			
Total Assets	5,256,460	5,675,804	-7.4%			
Deposits	3,165,955	3,396,182	-6.8%			
Total Liabilities	4,536,955	4,940,558	-8.2%			
Net Assets	719,505	735,246	-2.1%			
BVPS	22.92	23.42	-2.1%			
	H1 2018	H1 2017	change	Q2 18	Q1 18	change
Assets Yields	10.6%	13.1%	-2.4%	6.9%	10.7%	-3.8%
WACF	3.3%	6.3%	-3.0%	2.6%	4.1%	-1.5%
Net Interest Margin	7.2%	6.9%	0.2%	5.7%	8.6%	-2.9%
Cost-Income Ratio	52.7%	47.7%	5.0%	53.2%	52.2%	1.0%
Cost of Risk	1.0%	3.9%	-2.8%	1.1%	1.0%	0.1%
ROE	22.7%	20.9%	1.8%	19.3%	25.6%	-6.3%
CAR	21.0%	21.0%	0.0%			

Source: Company Financials, ARM Research

ARM ratings and recommendations

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6-month period (minimum) to the review date. We adopt a 5-point rating system for this category of stocks and a 3-point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
STRONG BUY	>20%	BUY	>20%
OVERWEIGHT	10% — 20 %	NEUTRAL	5% — 20 %
NEUTRAL	0% — 10 %	SELL	<5%
UNDERWEIGHT	-5% — 0%		
SELL	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject to reasonable portfolio constraints
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio
RESTRICTED	In certain circumstances, Asset & Resource Management ("ARM") Group policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of ARM Securities' and/or ARM Group's engagement in an investment banking transaction and in certain other circumstances.

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