



Equity Research | Zenith Bank Plc

ARM Research

[research@armsecurities.com.ng](mailto:research@armsecurities.com.ng)

+234 1 270 1652

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Interim Earnings Report

9 months ended 30<sup>th</sup> September, 2013

**Recommendation: BUY**

### ***Flat revenues match expectations***

- Zenith Bank (Zenith) reported 11% YoY rise in gross earnings to N255.3bn for the 9 months ended September 2013. PBT and PAT were respectively 10% and 9% higher YoY at N83bn and N69.8bn. Revenues nevertheless include an N11.7bn contribution from discontinued operations which also boosted PBT and PAT N2.9bn and N2.5bn respectively.
- After rotating out of securities (-19% QoQ) into loans (+4% QoQ) and cash (+88% QoQ), the resultant mild growth in total earning assets (+2%QoQ) was offset by a 30bps rise in asset yields to match our 9.5% FY 13 estimate. Accordingly, interest income of N62.6bn was flat QoQ and 2% short of our estimates which anticipated slightly faster growth in earning assets. Matching our estimates, non-interest revenue rose 5% QoQ to N17.9bn—underpinned by 12% QoQ recovery in fee income which outweighed flat trading gains of N5.2bn. Overall, Q3 13 gross earnings of N80.5bn (+1%QoQ) was in line with our estimates.

### Income Statement Data

	2013- 9 'm	2012 - 9 'm	%chg
Revenue	243,623	217,207	12%
PBT	80,096	72,006	11%
Tax	(12,815)	(10,851)	18%
PAT	67,281	61,155	10%

### Balance Sheet Data

	2013-Sep 'm	2012 -Dec 'm	%chg
Cash & equivalents	535,092	332,515	61%
Loans	1,108,872	989,814	12%
Deposits	2,033,971	1,929,244	5%
Fixed Asset	70,777	68,782	3%
Net Assets	482,509	462,956	4%

### Stock Data

Price	N21.85
52 week range	N16.45- N22.80
Market Cap. (N'm)	673,454.79
1-month Avg. Vol	28,746,081
Curr. PE	7.5x
Bloomberg Ticker	ZENITHBA NL
Reuters Ticker	ZENITHB.LG

### Zenith Plc - Share Price Trend



### Analyst(s)

Adeolu Omotola

[adeolu.omotola@arm.com.ng](mailto:adeolu.omotola@arm.com.ng)

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### ***But tame costs underpin profit outperformance***

- Interestingly, Zenith appeared immune to the adverse impact of regulatory measures on funding costs, expectations of which had prompted us to assume that funding cost reduction in Q2 13 would unravel. In contrast, Zenith's interest expense contracted 12% QoQ and was 22% behind of our estimates with WACF of 3.3% 20bps below both Q2 actual and our FY estimate.
- Our expectations for restructuring-related costs to recede in H2 13 panned out as staff costs declined mildly QoQ but dips in securities & cash handling (-25% QoQ) and 'other opex' (-10%QoQ) held greater sway. Nonetheless, the overall moderation in Q3 was somewhat slower than expected as opex dipped 4% QoQ to N35.2bn—still 3% ahead of our forecast—but was sufficient to drive a 70bps moderation in CIR to 55%. Impairments were also moderate, falling 26% short of our estimates in spite of a 12% QoQ rise to N2.3bn, as cost of risk dipped 10bps below both Q2 13 and FY 13 estimate level to 0.6%
- Lower interest expense and provisions were primarily responsible for profit improvement being stronger than expected; PBT of N28bn being 12% ahead of forecasts (+16%QoQ) though a higher than anticipated tax rate (15% vs 13% forecast) pegged PAT outperformance to 10% (+14%QoQ). Relative to the preceding quarter, lower interest expense and opex drove a 100bps expansion in each of PBT and PAT margin to 33% and 28% respectively.

### ***Q4 13 revenue optimism appears overdone***

- Though both revenues streams closely matched our expectations in Q3 13, we see regulatory measures, specifically lower T-bill issuance in face of sedate loan growth, as posing headwinds to significant improvement in Q4. Thus, whilst acknowledging signs that strong liquidity position has given Zenith the flexibility to improve performance in Q3 (in contrast to broad industry expectations) we have pegged back our somewhat optimistic Q4 13 revenue estimates from previous. A mild downscaling of total assets puts interest income 2% lower from previous to N64.3bn—still implying 3% QoQ growth—while we cut back non-interest revenue by 11% to N17.2bn, slightly behind the quarterly average thus far in 2013. Overall our Q4 13 revenue forecast is 4% lower from previous to N81.7bn—implying flat QoQ profile—while FY 13E revenue of N325bn is 1% lower from previous but still represents 11% YoY growth.
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***But adjusting costs for emerging trend implies improvement could be conserved to year end***

- Whilst our cost estimates have largely scaled down in line with revenues we make more drastic cutbacks to interest expense in light of the significant downside in current results which imply much greater success with funding cost control than we initially envisaged. Thus, we have revised our Q4 13 interest expense estimate 11% lower from previous to N17bn to match the quarterly average thus far in 2013 which, coupled with only mild adjustment to funding base, drives FY WACF estimate 30bps from lower to 3.2%, implying a further 10bps reduction from 9M 2013 level.
- We have maintained our operating costs flat from previous at N35bn as we expect restructuring related costs to recede further in Q4. The anticipated mild QoQ decline helps keep expected CIR unchanged at 55%. Despite underperformance of the line item relative to our Q3 estimate, we have revised provisions marginally higher to N2.9bn to reflect the steady uptrend thus far in 2013 as well as Zenith's increasing focus on loan growth. Overall while PBT estimate is 5% lower from previous at N27bn, mild cutback in tax charge puts expected PAT of N24bn at par with Q3 13.

***BUY rating still intact***

- Our revisions culminate in a 9% expansion in FY 13E PBT to N107bn while a negligible tax charge in the base period puts FY 13E PAT 7% lower YoY (EPS N2.9). Additionally, we let some of the revenue and costs revisions we made filter out into the medium term with lower costs having a greater impact on profitability. Reflecting these changes, our fair value estimate is now at **N26**, from N25 previously, and implies upside potential of 21% relative to last market close. Adjusted (for tax-write backs) current PE of 7.5x is ahead of peer average of 6.1x while forward PE of 7.4x and P/Bv of 1.4x compare with respective peer averages of 6x and 1.3x—premiums which we believe justified by Zenith maintaining some of the best efficiency and profitability ratios in the industry. Based on the current upside to our fair value estimate, we continue to rate the stock a **STRONG BUY**.
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## Summary of Forecasts

Quarterly					
Income Statement (N'm)	Q4 2013E	Q1 2014E	Q2 2014E	Q3 2014E	
Net interest income	47,487	49,869	51,947	50,908	
Non-interest income	17,304	20,268	21,113	20,690	
<b>Total Revenue</b>	<b>64,792</b>	<b>70,137</b>	<b>73,060</b>	<b>71,598</b>	
Total Operating Costs	(34,922)	(37,564)	(39,130)	(38,347)	
<b>Operating Profit</b>	<b>29,870</b>	<b>32,573</b>	<b>33,930</b>	<b>33,251</b>	
Impairment Charge	(2,873)	(3,848)	(4,009)	(3,928)	
<b>Pre-tax Profit</b>	<b>26,996</b>	<b>28,725</b>	<b>29,921</b>	<b>29,323</b>	
Tax	(3,249)	(5,745)	(5,984)	(5,865)	
<b>Post-tax Profit</b>	<b>23,747</b>	<b>22,980</b>	<b>23,937</b>	<b>23,458</b>	
Annual					
Income Statement (N'm)	2012A	9m' 2013	2013E	2014E	2015E
Net interest income	156,757	138,979	186,466	207,788	236,359
Non-interest income	70,530	52,655	69,959	84,450	100,874
<b>Total Revenue</b>	<b>227,287</b>	<b>191,634</b>	<b>256,426</b>	<b>292,238</b>	<b>337,232</b>
Total Operating Costs	- 119,619	(105,599)	(140,521)	(156,518)	(176,524)
<b>Operating Profit</b>	<b>107,668</b>	<b>86,035</b>	<b>115,905</b>	<b>135,720</b>	<b>160,708</b>
Impairment Charge	- 9,099	(5,939)	(8,812)	(16,034)	(16,967)
<b>Pre-tax Profit</b>	<b>98,592</b>	<b>80,096</b>	<b>107,092</b>	<b>119,686</b>	<b>143,741</b>
Tax	- 462	(12,815)	(16,064)	(23,937)	(31,623)
<b>Post-tax Profit</b>	<b>98,130</b>	<b>67,281</b>	<b>91,028</b>	<b>95,749</b>	<b>112,118</b>
Balance Sheet (N'm)					
Assets	2012A	9m' 2013	2013E	2014E	2015E
Cash & Short term funds	1,001,679	999,991	948,074	1,028,721	1,164,440
Due from banks	182,020	284,343	293,675	335,694	427,697
Net Loans	989,814	1,108,872	1,156,083	1,367,586	1,537,801
Fixed Assets	68,782	70,777	71,979	82,278	92,978
Other Assets	362,209	388,778	408,841	477,212	531,832
<b>Total Asset</b>	<b>2,604,504</b>	<b>2,852,761</b>	<b>2,878,651</b>	<b>3,291,490</b>	<b>3,754,747</b>
Liabilities					
Deposits	1,929,244	2,033,971	2,064,433	2,357,907	2,651,381
Due to banks	-	-	-	-	-
Borrowings	71,204	92,641	71,187	101,445	124,771
Other liabilities	141,100	243,640	237,291	282,400	343,120
<b>Total liabilities</b>	<b>2,141,548</b>	<b>2,370,252</b>	<b>2,372,912</b>	<b>2,741,752</b>	<b>3,119,271</b>
<b>Shareholders' fund</b>	<b>462,956</b>	<b>482,509</b>	<b>505,739</b>	<b>549,738</b>	<b>635,476</b>
Key Data					
EPS	3.13	2.15	2.88	3.03	3.55
DPS	1.60	-	1.59	1.67	2.13
BVPS	14.75	15.37	16.11	17.51	20.24
ROE	21%	14%	18%	17%	18%
ROA	3.8%	2.4%	3.1%	2.9%	3.0%
Key Ratios					
Loan to Asset	38%	39%	40%	42%	41%
Cost to income	53%	55%	55%	54%	52%
Net Profit Margin	33%	29%	28%	26%	27%
Liquidity ratio	61%	63%	60%	58%	60%
Capital adequacy ratio	31%	20%	37%	35%	34%

Source: Company financials, ARM Estimates

### 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	Minimise exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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