

Zenith Bank Plc. (ZENITH.NL)

Stock Report

Few concerns, but compelling dividend yield

- *We have made adjustment to our FY 2019 expectation for Zenith Bank following some surprises in the Q2 numbers and clarification at the management call last week. In specifics, we revised net interest income lower due to compressed yields on its loans and treasury asset (H1 18:10.6%, H1 19 9.1%) amidst contraction in funding cost. Elsewhere, we adjusted NIR higher due to upward review of electronic fee income and trading book. Holding all other lines unchanged, we now forecast PBT of ₦218 billion (-5.5% YoY), with H1 2019 PBT now printing at 51% of our revised FY 19E. Consequently, we cut our FVE to ₦31.57/share (previously: ₦33.71/share) but maintain our BUY rating on the stock. Zenith trades at a FY19 P/B of 0.6x on an ROE of 22% relative to GTB of 1.2x on an ROE of 28%.*
- Key highlights from the H1 19 call include: 1) the moderation in net interest margin (NIM), which management attributed to lower reinvestment rate of matured swap positions and competition in the pricing of loans; 2) higher fee on electronic products was driven by retail initiatives and a similar run-rate is expected in H2; and 3) the growth in Q2 19 impairments was linked to provisioning in the manufacturing sector and prudent provisioning across other sectors. Management FY 19 guidance for cost of risk was maintained at 1.0% (1H19:1.4%) as they expect increase in loan book to moderate the impact of the provisioning. Our follow up engagement further revealed that higher treasury trading income was due matured swap positions in Q1 that were reinvested at the beginning of Q2.
- In view of the aforementioned, we revise our FY19 NIR estimate upwards by 26%, emanating from upward revision to our fee income and treasury bills trading income estimates. Contrary to our expectation of a moderate growth in electronic transactions, total value and volume of transactions increased 70% and 61% YoY to ₦8.7 trillion and 170 billion respectively in H1 19. On treasury bills trading, with the proportion of FVTPL now remaining stable at 52% (8% in Q1 19) of the treasury book, we see lower mark to market gains over H2. However, we revise FY 19 treasury gains estimate higher to ₦84 billion (previous: ₦65.2 billion), which is still lower compared to FY 18. With derivatives loss and bonds trading income still in line with our estimate, we expect trading income to decline 23% YoY. The upward revision in our NIR forecast is fully neutered by 14.2% reduction in NII

Rating	STRONG BUY
Price	₦18.35
FVE	₦31.57
52-week range	₦16.00-26.85
Market Cap. (₦bn)	576,126
1-month Avg. Vol	19,091,549
Curr. PB	0.70x

ZENITH.NL - Share Price Trend



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forecasts. The adjustment in NII emanated largely from downward revision of yields on loans and treasury assets to 12% and 10.2% (previous: 12.4% and 10.8%) respectively, and revised loan growth estimate of 2.5% YoY from 5.2%.

- We value Zenith Bank at **₦31.57** which implies a potential return of 72.0%. We have a **STRONG BUY** recommendation. We note however, that the banks valuation may remain depressed in the near-term given the regulatory overhang over the industry. Nonetheless, at current levels and based on our FY 19E dividend of ₦2.90, we view expected dividend yield of 15.8% as attractive and could be compelling to investors. On our numbers, Zenith is trading on FY19 P/E and P/B multiples of 3.2x, and 0.6x, respectively, which is at a discount to GUARANTY's FY19 P/E and P/B multiples of 4.3x, and 1.2x.

Summary of H1 2019 Result

N'million	H1 19	H1 18	YoY (pps)	Q1 19	Q2 19	QoQ
Gross Earnings	286,485	285,394	0.4%	169,195	155,136	9.1%
Net Interest Income	142,515	153,961	-7.4%	56,378	86,137	-34.5%
Non-Interest Revenue	109,730	88,595	23.9%	77,074	32,656	136.0%
Operating Expenses	(126,833)	(125,478)	1.1%	(67,429)	(59,404)	13.5%
Impairment	(13,735)	(9,720)	41.3%	(11,639)	(2,096)	455.3%
PBT	111,677	107,358	4.0%	54,384	57,293	-5.1%
PAT	88,882	81,737	8.7%	38,648	50,234	-23.1%
EPS	2.83	2.60	8.7%	1.23	1.60	-23.1%
N'million	H1 19	H1 18	YoY (pps)	Q1 19	Q2 19	
Loans	1,801,833	1,873,173	-3.8%	1,792,276	-0.5%	
Total Assets	5,898,596	5,256,460	12.2%	5,879,172	-0.3%	
Deposits	3,810,025	3,165,955	20.3%	3,571,370	-6.3%	
Total Liabilities	5,079,082	4,536,955	11.9%	5,098,284	0.4%	
Net Assets	819,514	719,505	13.9%	780,888	-4.7%	
BVPS	26.10	22.92	13.9%	24.87	-4.7%	
	H1 19	H1 18	change (pps)	Q1 19	Q2 19	change (pps)
Assets Yields	9.1%	10.6%	-1.5%	8.9%	6.7%	2.2%
WACF	3.0%	3.3%	-0.3%	3.1%	3.0%	0.1%
Net Interest Margin	6.1%	7.2%	-1.1%	7.8%	5.1%	2.8%
Cost-Income Ratio	50.3%	51.7%	-1.4%	50.0%	50.5%	-0.5%
Cost of Risk	1.5%	1.0%	0.5%	0.5%	2.6%	-2.1%
ROE	21.7%	22.7%	-1.0%	25.2%	19.3%	5.9%
CAR	25.0%	21.0%	4.0%	25.0%	25.0%	0.0%
Loan to Deposit Ratio (Bank)	62.7%	61.5%	1.2%			
Loan to Deposit Ratio (Group)	51.2%	54.6%	-3.4%			

Summary of Results and Forecasts - N'000

Balance Sheet	2017	2018	2019E	2020E	2021E
Assets					
Inv. Securities	1,735,778	2,158,807	2,130,911	2,301,384	2,416,454
Net loans	2,100,362	1,823,111	1,869,314	1,957,546	2,044,639
Interest-earning assets	5,289,606	5,610,608	5,697,905	6,059,442	6,486,959
Total assets	5,595,253	5,955,710	6,029,781	6,397,724	6,831,188
Liabilities					
Borrowings	1,072,461	1,191,732	1,072,559	1,179,815	1,297,796
Deposits	3,437,915	3,690,295	3,873,455	4,015,014	4,211,051
Interest-bearing liabilities	4,510,376	4,882,027	4,946,014	5,194,828	5,508,847
Total liabilities	4,783,137	5,139,959	5,203,946	5,452,760	5,766,779
Shareholders' Equity	812,116	815,751	825,835	944,963	1,064,408

Income Statement	2017	2018	2019E	2020E	2021E
Interest Income	474,628	440,052	418,112	483,404	512,085
Interest Expense	(216,637)	(144,458)	(143,945)	(160,564)	(170,620)
Net Interest Income	257,991	295,594	274,167	322,840	341,466
Net Fee Income	82,548	81,814	119,352	124,970	135,624
Other Income	22,444	17,947	15,305	16,601	17,746
Trading Income	157,974	80,202	61,810	58,681	44,311
NIR	262,966	179,963	196,467	200,252	197,681
Staff Costs	(64,459)	(68,556)	(70,280)	(72,048)	(74,534)
Other Costs	(158,952)	(156,944)	(162,673)	(167,399)	(176,883)
Total Costs	(223,411)	(225,500)	(232,954)	(239,447)	(251,417)
Operating Profit	297,546	250,057	237,680	283,645	287,730
Provision Charge	(98,227)	(18,372)	(18,693)	(21,533)	(20,446)
PBT	199,319	231,685	218,987	262,112	267,284
Tax	(25,528)	(38,261)	(37,228)	(42,165)	(42,591)
Net Profit	173,791	193,424	181,759	219,947	224,693

Key YoY growth rates (%)	2017	2018	2019E	2020E	2021E
Loans	-8.3%	-13.2%	2.5%	4.7%	4.4%
Interest Earning Assets	17.5%	6.1%	1.6%	6.3%	7.1%
Deposits	15.2%	7.3%	5.0%	3.7%	4.9%
Interest Bearing Liabilities	20.2%	8.2%	1.3%	5.0%	6.0%
Assets	18.0%	6.4%	1.2%	6.1%	6.8%
Gross Earnings	16.0%	-6.6%	-2.3%	13.2%	6.5%
Costs	28.0%	0.9%	3.3%	2.8%	5.0%
PBT	27.2%	16.2%	-5.5%	19.7%	2.0%
PAT	34.0%	11.3%	-6.0%	21.0%	2.2%

Per-share data (N)	2017	2018	2019E	2020E	2021E
No of common shares (mn)	31,396,494	31,396,494	31,396,494	31,396,494	31,396,494
EPS	5.54	6.16	5.79	7.01	7.16
DPS	2.70	2.80	2.90	3.23	3.37
BVPS	25.87	25.98	26.30	30.10	33.90

Balance-sheet ratios (%)	2017	2018E	2019E	2020E	2021E
Loan/Assets	37.5%	30.6%	31.0%	30.6%	29.9%
Deposit/Liabilities	71.9%	71.8%	74.4%	73.6%	73.0%
Loans/Deposits (Group)	65.5%	54.6%	53.6%	52.8%	51.8%
Assets/Equity	6.89	7.30	7.30	6.77	6.42

Asset Quality	2017	2018E	2019E	2020E	2021E
NPLs/Gross Loans (%)	4.7%	5.0%	5.0%	4.0%	3.5%
Margins (%)	2017	2018E	2019E	2020E	2021E
Asset Yield	9.7%	8.1%	7.4%	8.2%	8.2%
WACF	5.2%	3.1%	2.9%	3.2%	3.2%
NIM	5.27%	5.42%	4.85%	5.49%	5.44%
Costs (%)	2017	2018E	2019E	2020E	2021E
Cost/Income	42.9%	47.4%	49.5%	45.8%	46.6%
Effective tax rate	12.8%	16.5%	17.0%	16.1%	15.9%
Profitability ratios (%)	2017	2018E	2019E	2020E	2021E
RoAE	22.9%	23.8%	22.1%	24.8%	22.4%
RoAA	3.4%	3.3%	3.0%	3.5%	3.4%

Source: ARM Research *unless otherwise stated

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 reas portfolio constraints
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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