



Rating	<b>STRONG BUY</b>
Price	₦23.90
FVE	<b>₦38.17</b>
52-week range	₦19.60 – ₦31.90
Market Cap. (₦mn)	751,946
1-month Avg. Vol	64,507,920
Curr. PB	0.89x

### ZENITHBANK.NL - Share Price Trend



### Analyst(s)

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## Zenith Bank Plc. (ZENITHBANK.NL)

### Stock Report

#### Where will growth come from?

- Following the release of its FY 18 results, we had engagement with management to seek clarity on grey areas in the result and guidance for the year ahead. Management guided to 7.5% loan growth over 2019 with a lot of focus on Agriculture and manufacturing given government incentives to drive growth in these sectors. Management stated that they see some opportunities in the differentiated cash reserve ratio introduced by the MPC over 2018. With its focus on driving retail penetration, they guided to deposit growth of 10% YoY with ~50% of it coming from the retail customers. CAR is expected to remain flat, slight improvement in NPL to 4.8% (with coverage of 180%), and cost of risk and cost of funds to worsen to 1% and 3.5% respectively (in line with prior year guidance). Overall, management estimate PBT and EPS growth of 4% and 6% YoY respectively.
- We retain our **STRONG BUY** rating on Zenith with a revised FVE of ₦38.17/share (from ₦38.83/share). Over 2019, we forecast EPS of ₦6.57 which is 7% higher than 2018 (₦6.16). Growth in earnings mainly reflects i) expansion in assets yield (+37bps YoY to 8.5%) from increase in loan book which would more than outweigh funding cost to support moderate expansion in NIM to 5.5% ii) increase in NIR following resilience in fee income and ii) improvement in asset quality with non-performing loan (NPL) ratio of 4.5% (-48bps YoY), slower expansion in cost of risk (CoR) to 1.0% with related loan loss provision of ₦19.2 billion (2018: ₦18 billion). Zenith trades at a FY 19E P/B of 0.9x, at a discount to GUARANTY of 1.3x, which is justified given the former's strong and sustainable ROE. At current price, expected dividend of ₦2.92 over FY 19E translates to a dividend yield of 12.3%.

- **Low-priced deposit mobilisation to persist, but short of guidance.** With management achieving a strong fit on its low-cost funding over 2018, we expect a further consolidation going into 2019. Specifically, with CASA<sup>1</sup> share of deposits expanding 200bps YoY to 66% in FY 18, we see further improvement to 67% going into 2019. In line with the drive for savings deposits growth (and conscious reduction of term deposits) we expect deposit growth of 7% (FY 18: 7.3% YoY) to ₦3.9 trillion, relative to management's guidance of 10% YoY as we expect competition within the retail space to limit the scope for further expansion with banks scouting to solidify their presence ahead of the entrance of payment service banks.
- **Sticky NPL to drive appetite for short-dated facility.** Within our coverage, we note that Zenith has significant room for loan growth over 2019 with loan to deposit ratio settling at 44.2% in FY 18. However, given the still elevated NPL, we sense management appetite for short dated instruments compared to term loans. With that in mind, we believe management will continue its drive to reduce duration of its loan book, which informed our effective FY 19 loan growth of 5% (net loan growth of 3.2% to ₦1.9 trillion) which tracks below management guidance of 7.5%. Beyond actual loan growth, we note that lower duration of the loan book as evidenced in FY 18 increases the velocity of its loan book and thus creates upside for credit related fee income.
- On NPL, the deterioration over 2018 largely reflected further weakening in the quality of the bank's exposure to manufacturing, real estate & construction. For clarity, despite the marginal increase in term loans, manufacturing NPL grew further to ₦31 billion (FY 17: ₦6.4 billion), Real estate & construction to ₦13.1 billion (FY 17: ₦7.4 billion), while oil & gas NPL improved to ₦38.4 billion (FY 17: ₦39.6 billion). To limit further deterioration over 2019, the bank restructured 36% (\$822 million) of its FCY loans across oil & gas (\$634 million), power (\$70 million), manufacturing (\$80 million) and other sectors (\$38 million). With the total restructured loans representing 16% of gross loans amidst our expectation of further improvement across the troubled sectors, we estimate slight moderation in NPL over 2019 to 4.5%.

Cumulative Restructured Loans – 2018				
Restructured Loans	US\$' m	₦' m	% Restructured loans	% to net loans
Oil and gas	634	227,474	77.1%	12.5%
Power	70	25,228	8.6%	1.4%
Manufacturing	80	28,622	9.7%	1.6%
Others	38	13,606	4.6%	0.7%
<b>Total restructured loans</b>	<b>822</b>	<b>294,930</b>	<b>100.0%</b>	<b>16.2%</b>

Source: Company Presentation, ARM Research

<sup>1</sup> Current Account Savings Account

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- ***Lower provisioning... more room to shrink.*** From a high of 4.7% in FY 17, the improved macroeconomic environment supported contraction in CoR to 0.9% in FY 18. With our outlook suggesting improvement in asset quality over 2019 with management preference for short dated maturity amidst restructuring of exposures across oil & gas, power and manufacturing, we do not foresee any significant pressure during the year. Also, with the expected reversal of excess provisioning on 9Mobile following the full resolution, we see the impact dwarfing CoR in the course of the year. Overall, we estimate further a moderate expansion in CoR to 1.0% in line with management guidance, which implies loan-loss provision of ₦19.2 billion (+4% YoY) over 2019.
  - On the ongoing talks between government and petroleum marketers which DMBs have been asked to reverse interest on subsidy-induced loans spanning the period of June 2017 to December 2018, Management guided that such reversal will have little or no effect as its exposure to the downstream sector is below ₦200 billion. The reversal is expected to be done in the course of the year when proceeds of the promissory notes for fuel subsidy related loans are received.
  - ***Impact of lower yields will be largely muted on NIMs.*** We expect flat to lower interest environment over 2019, as the lower maturity profile for treasury assets for most part of the year amidst strong foreign exchange reserves suggests mild pressure on the apex bank as regards system liquidity pressure. As such, we expect relatively sticky yield on loan book and investment securities. However, with the bank guiding to an aggressive loan growth in the course of the year with our estimate suggesting appetite for shorter tenures, we expect effective yield on loans to be higher. Thus, we estimate 42bps expansion in asset yield to 8.5% in FY 19E (FY 18: 8.1%). On the funding side, while we acknowledge the downward re-pricing of maturing term deposits and continued retail drive for cheaper savings deposits, we believe liquidity concerns will limit the bank's ability to shut out term deposits in the course of the year. As such, we are largely in-tune with management guidance on funding costs of 3.5% (+42bps YoY). Therefore, Net Interest Margin (NIM) is estimated to expand just 4bps YoY to 5.5%.
  - ***Fee Income to remain resilient.*** We estimate non-interest revenue (NIR) to remain strong over 2019 reflecting resilience in fee income, which offsets declines in other operating income (-14% YoY) and trading income (-16% YoY to ₦67 billion). On the former, we expect the lower legroom for naira depreciation in the course of the year to dwarf gains on assets revaluation. On trading income, management guided to an increase in its derivative books to \$1.8 billion at the end of 2018, and it intends to settle the maturing \$500 million Eurobond in April using dollar proceeds from maturing derivative contracts. As a result, we expect the bank's derivative position

to decline by same amount and estimate a further loss on the position of ₦18 billion over 2019. Furthermore, we estimate lower gains on treasury assets trading of ₦86 billion over 2019.

- **Earnings growth in the near term.** Net impact of our overall adjustment translates to PBT of ₦248.3 billion and EPS of ₦6.57 (+7% YoY) over 2019. We forecast EPS of ₦6.74 (+3% YoY) and ₦6.83 (+1% YoY) over FY 20F and FY 21F respectively. ZENITH trades at a FY 19E P/B of 0.9x, at a discount to GUARANTY of 1.3x, which is justified given the former's strong and sustainable ROE. At current price, our expected dividend of ₦2.96 over FY 19E translates to a dividend yield of 12.3%.

## Summary of Results and Forecasts

Balance Sheet	2017	2018	2019E	2020E	2021E
<b>Assets</b>					
Inv. Securities	1,735,778	2,158,807	2,444,183	2,693,460	2,828,133
Net loans	2,100,362	1,823,111	1,917,610	2,006,473	2,102,311
Interest-earning assets	5,289,606	5,610,608	6,090,359	6,536,338	7,095,565
<b>Total assets</b>	<b>5,595,253</b>	<b>5,955,710</b>	<b>6,370,064</b>	<b>6,826,623</b>	<b>7,395,636</b>
<b>Liabilities</b>					
Borrowings	1,072,461	1,191,732	1,310,905	1,441,996	1,586,195
Deposits	3,437,915	3,690,295	3,952,839	4,163,699	4,474,457
Interest-bearing liabilities	4,510,376	4,882,027	5,263,744	5,605,695	6,060,652
Total liabilities	4,783,137	5,139,959	5,521,676	5,863,627	6,318,584
<b>Shareholders' Equity</b>	<b>812,116</b>	<b>815,751</b>	<b>848,389</b>	<b>962,996</b>	<b>1,077,052</b>
<b>Income Statement</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>
Interest Income	474,628	440,052	496,588	515,810	547,984
Interest Expense	(216,637)	(144,458)	(177,115)	(184,691)	(198,881)
Net Interest Income	257,991	295,594	319,473	331,119	349,104
Net Fee Income	90,143	92,143	97,920	102,411	111,067
Other Income	22,444	98,149	83,072	80,154	67,495
Gross Earnings	589,215	550,142	594,508	618,221	659,051
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
PBT	199,319	231,685	248,336	252,166	255,226
Provision Charge	(98,227)	(18,372)	(19,176)	(22,071)	(21,023)
Tax	(25,528)	(38,261)	(42,217)	(40,565)	(40,669)
<b>Net Profit</b>	<b>173,791</b>	<b>193,424</b>	<b>206,119</b>	<b>211,601</b>	<b>214,556</b>

Key YoY growth rates (%)	2017	2018	2019E	2020E	2021E
Loans	-8.3%	-13.2%	5.2%	4.6%	4.8%
Interest Earning Assets	17.5%	6.1%	8.6%	7.3%	8.6%
Deposits	15.2%	7.3%	7.1%	5.3%	7.5%
Interest Bearing Liabilities	20.2%	8.2%	7.8%	6.5%	8.1%
Assets	18.0%	6.4%	7.0%	7.2%	8.3%
Gross Earnings	16.0%	-6.6%	8.1%	4.0%	6.6%
Costs	28.0%	0.9%	3.3%	2.8%	5.0%
PBT	27.2%	16.2%	7.2%	1.5%	1.2%
PAT	34.0%	11.3%	6.6%	2.7%	1.4%

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	6.57	6.74	6.83
DPS	2.70	2.80	2.96	3.11	3.22
BVPS	25.87	25.98	27.02	30.67	34.30

Balance-sheet ratios (%)	2017	2018	2019E	2020E	2021E
Loan/Assets	37.5%	30.6%	30.1%	29.4%	28.4%
Deposit/Liabilities	71.9%	71.8%	71.6%	71.0%	70.8%
Loans/Deposits	61.1%	49.4%	48.5%	48.2%	47.0%
Assets/Equity	6.89	7.30	7.51	7.09	6.87

Asset Quality	2017	2018	2019E	2020E	2021E
NPLs/Gross Loans (%)	4.7%	5.0%	4.5%	3.5%	2.8%

Margins (%)	2017	2018	2019E	2020E	2021E
Asset Yield	9.7%	8.1%	8.5%	8.2%	8.0%
WACF	5.2%	3.1%	3.5%	3.4%	3.4%
NIM	5.27%	5.42%	5.46%	5.24%	5.12%

Costs (%)	2017	2018	2019E	2020E	2021E
Cost/Income	42.9%	47.4%	46.5%	46.6%	47.6%
Effective tax rate	12.8%	16.5%	17.0%	16.1%	15.9%

Profitability ratios (%)	2017	2018	2019E	2020E	2021E
RoAE	22.9%	23.8%	24.8%	23.4%	21.0%
RoAA	3.4%	3.3%	3.3%	3.2%	3.0%

## 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
<b>STRONG BUY</b>	>20%	<b>BUY</b>	>20%
<b>OVERWEIGHT</b>	10% — 20 %	<b>NEUTRAL</b>	5% — 20 %
<b>NEUTRAL</b>	0% — 10 %	<b>SELL</b>	<5%
<b>UNDERWEIGHT</b>	-5% — 0%		
<b>SELL</b>	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
<b>BUY</b>	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
<b>OVERWEIGHT</b>	Accumulate security to an extent moderated by cognizance of its benchmark weight
<b>NEUTRAL</b>	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
<b>UNDERWEIGHT</b>	Minimize exposure to security taking cognizance of its index weighting
<b>SELL</b>	Sell-off security completely from portfolio

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