

Zenith Bank Plc.

First Glance: EPS Beats Consensus' as Higher Yields Drove Interest Income Northwards

Zenith Bank Plc (ZENITHBANK) published Q1-2017 result last week, reporting double-digit growth across most line items – gross earnings surged 48.58% y/y and 15.74% q/q, supported by impressive growth in interest income (+40.29% y/y and 19.43% q/q) and non-interest income (94.28% y/y and 3.07% q/q). Both lines grew in line with our estimates. ZENITHBANK's annualized EPS of N4.76 is above consensus estimate of N3.71.

The strong y/y growth in interest income (6.29% variance from our estimate) was on the back of expansion in the naira yield curve, with resultant impact on interest income on treasury bills (+131.27% y/y), and asset re-pricing which buoyed interest income on loans (+31.99% y/y). Despite the growth recorded in interest income, net interest margin contracted 20 bps y/y to 7.70%, as funding costs tracked significantly higher by 180 bps. Breakdowns of the surge in interest expense (+82.51% y/y and -2.13% q/q) revealed higher costs on borrowed funds (+37.71% y/y), due to translation impact of NGN depreciation on FCY borrowing and deposits – CASA (+85.34% y/y) and term deposits (+99.02% y/y) broadly reflective of the relatively higher interest rate environment.

On non-interest income (NIR), the impressive y/y growth largely stemmed from strong fee income (34.85% y/y due to higher account maintenance fees) and monumental growth in trading income.

Asset quality deterioration persists, with NPL ratio rising 100 bps y/y to 3.20%, while further provisioning pushed cost of risk 80 bps higher to 1.30%, following exposure to the power sector – distribution companies (Ikeja & Eko Disco both in Lagos) and generating companies (Geregu, Shiroro and Egbin) – and oil & gas sector. The largest chunk of the continuous deterioration in asset quality, in our view, stemmed from the power sector (which accounted for 43.00% of total NPL in FY-2016), as the exclusion of key variables (inflation, interest rates, and FX) from the multi-year tariff order (MYTO) template created revenue shortfalls across the sector.

Still on the negatives, total opex rose 24.24% y/y and 45.25% q/q (12.66% above our estimate), following hikes in personnel expenses (+7.59% y/y and +28.55% q/q), operating expenses (+39.94% y/y and +67.92% q/q), and depreciation expenses (+15.89% y/y and +1.73% q/q). Notably, the higher than expected surge in operating expenses stemmed from higher regulatory fees (AMCON), IT expenditures, and fuel and maintenance expense. Following the cost pressure, cost to income ratio tracked ahead of our 47.41% estimate to 52.14%. Parsing through the balance sheet, ZENITHBANK's loan book grew marginally (2.63% from FY-2016 level), while treasury bills and investment securities portfolio were up 15.97% and 11.27%, from FY-2016 level, in line with the trend observed across most banking names.

BUY

Target Price (N)*	18.24
Current Price (N)	15.37
Implied Return (%)	18.65

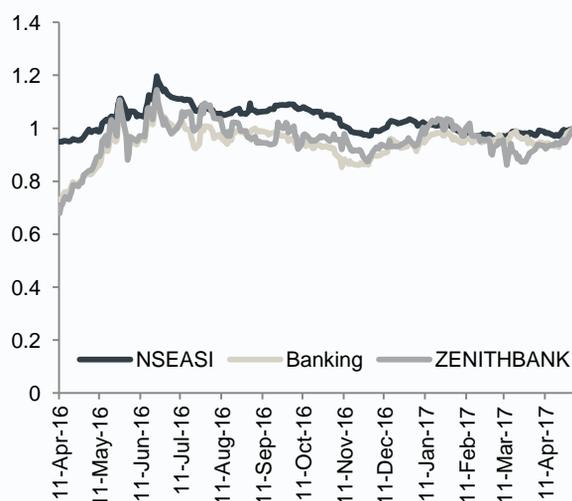
Company Data

NSE Code	ZENITHBANK
Bloomberg Code	ZENITHBA:NL
Reuters Code	ZENITHB.LG
Sector	FINANCIAL SERVICES
Market Cap. (N'bn)	485.08
Free Float (%)	90.45

Ratios	Q1-2017	Q1-2016	2016FY
Net Interest Margin	7.7%	7.9%	7.4%
Cost to Income	52.1%	54.7%	52.7%
Cost of funds	5.0%	3.2%	4.2%
Cost of Risk	1.3%	0.5%	1.4%
Liquidity Ratio	66.0%	47.7%	59.6%
CAR	22.0%	21.0%	23.0%
NPL/Total Loans	3.2%	2.2%	3.0%

*Under Review **Trailing 12m

Price movement (ZENITHBANK vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

For the rest of 2017, we expect ZENITHBANK's interest income to remain driven by yields on investment securities and FX interest income, as organic loan growth will remain subdued in the course of the year. Also, ZENITHBANK's long FCY position still leaves a significant legroom for FX translation gains, and further supported by the improvement on the fee income line, we expect NIR to remain elevated.

On the cost side, we expect pressure to persist, and further assets deterioration will likely drive cost of risk above management's guidance of 1.5%. Based on our last TP of N18.24, at 18.65% premium to current market price of N15.37, we have a HOLD recommendation on the stock. Our estimates are under review.

Highlight (N'Mn)	Q1-2017	Q1-2016	Y/Y	Cordros' Estimate	Variance
Gross Earnings	147,736	99,435	48.58%	134,730	9.65%
Interest Income	118,092	84,177	40.29%	111,102	6.29%
Interest Expense	(47,488)	(26,020)	82.51%	(41,455)	14.55%
Net Interest Income	70,604	58,157	21.40%	69,647	1.37%
Provisions	(7,886)	(2,577)	206.01%	(3,115)	153.13%
Non-Interest Revenue	29,644	15,258	94.28%	23,628	25.46%
Operating Income	92,362	70,838	30.38%	90,159	2.44%
OPEX	(48,162)	(38,765)	24.24%	(42,748)	12.66%
PBT	44,200	32,121	37.60%	47,411	-6.77%
Taxation	(6,701)	(5,548)	20.78%	(7,444)	-9.98%
PAT	37,499	26,573	41.12%	39,967	-6.18%

Disclosures

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