

Zenith Bank Plc.

First Glance: Impressive Growth in Gross Earnings Masks Surge in Credit Loss Provision, EPS Ahead of Consensus'

Zenith Bank Plc (ZENITHBANK) released audited H1-17 results yesterday, reporting double-digit growth across most line items – gross earnings surged 77.10% y/y, supported by impressive growth in interest income (+44.57% y/y) and non-interest income (253.80% y/y). Accordingly, PBT (+45.67% y/y) and PAT (+67.96% y/y) moved in the same direction, ahead of our estimates of 35.65% y/y and 58.45% y/y respectively, resulting in annualized EPS of N2.40. However, in other comprehensive income (OCI), ZENITHBANK recorded a loss of N4.88 billion (due to fair value movements on equity instruments and FX translation differences for foreign operations) compared to a gain of N30.21 billion in H1-16. Consistent with its dividend payment, ZENITHBANK is proposing an interim dividend of N0.25 (same as previous year) – translating to payout ratio of 10.42% and a dividend yield of 1.04%.

The strong y/y growth in interest income was buoyed by impressive growth on interest on loans and advances to customers (35.21% y/y) and interest income on treasury bills (+154.10% y/y) – translating to annualized asset yield expansion of 207 bps y/y to 13.61%.

Despite the expansion recorded in asset yields, net interest margin contracted 43 bps y/y to 7.6%, as funding costs spiked by 320 bps y/y to 6.4%. Breakdowns of the surge in interest expense (+126.71% y/y) revealed higher costs on borrowed funds (+14.55% y/y) and deposits – CASA (+46.85% y/y) and term deposits (+210.08% y/y) broadly reflective of the relatively higher interest rate environment.

The impressive y/y growth in non-interest income (NIR) largely stemmed from strong fee income (22.97% y/y, due to growth in credit related fees, financial guarantees, E-banking fees, FCY translation fees, asset management fees, and commission on agency fees), surge in trading income (driven by FX and T'bills trading income), and monumental growth in other income – due to a writeback of previous provisions amounting to N8.4 billion and FX revaluation gain of N5 billion.

Specifically, on the performance in Q2-17, gross earnings grew significantly by 57.51% q/q (101.69% y/y), while PBT and PAT expanded by 8.56% q/q (53.99% y/y) and 0.85% q/q (107.00% y/y), respectively. The earnings growth broadly reflects impressive performance across key line items; interest income grew by 22.08% q/q (48.27% y/y) while NIR surged 198.67% q/q (387.93% y/y).

In a deviation from the q/q decline in credit loss provision in Q1-17, asset quality deteriorated in Q2-17 with an additional provisioning of N34 billion (337.64% q/q), to increase total provisioning in the first half to N42 billion (197.915 y/y) – equating to annualized cost of risk of 3.8%, an expansion of 230 bps y/y. It is our view that the provisioning relates to the bank's exposure to the power sector – distribution companies (Ikeja & Eko Disco both in Lagos) and generating companies (Geregu, Shiroro and Egbin) – and oil & gas sector.

BUY

Target Price (N)*	30.63
Current Price (N)	24.00
Implied Return (%)	27.62

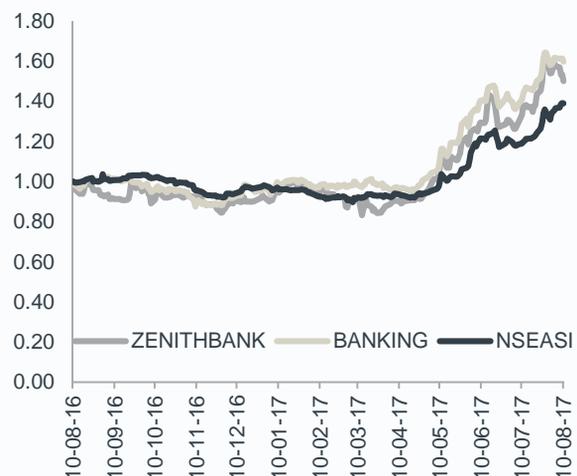
Company Data

NSE Code	ZENITHBANK
Bloomberg Code	ZENITHBA:NL
Reuters Code	ZENITHB.LG
Sector	FINANCIAL SERVICES
Market Cap. (N'bn)	753.52
Free Float (%)	90.45

Ratios	H1-2017	H1-2016	2016FY
Cost of funds	6.4%	3.2%	4.2%
Net Interest Margin	7.6%	8.0%	7.4%
Cost of Risk	3.6%	1.3%	1.4%
NPL/Total Loans	4.3%	2.3%	3.0%
CAR	21.0%	19.0%	23.0%
Liquidity Ratio	61.1%	55.2%	59.6%
Cost to Income	57.1%	56.7%	52.7%
Loan to Deposit	66.2%	71.3%	67.8%

*Under Review **Trailing 12m

Price movement (ZENITHBANK vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

Total opex rose 47.67% y/y, broadly driven by a surge in operating expenses (85.77% y/y) – notably, the higher than expected growth in operating expenses stemmed from higher regulatory fees (AMCON), training and development, IT/E-business expenditures, and fuel and maintenance expense – and depreciation expenses (+20.42% y/y). Following the cost pressure, cost to income ratio rose to 57.07% from 56.71% in H1-16.

Given we had expected the declassification of some NPLs (especially Oil & gas – upstream and downstream –, and general commerce), we are therefore concerned about the additional classifications in the review period (NPL rose to 4.3% from 3.2% in Q1-17 and 3.0% in FY-16). We attribute this partly to accrued interest on already classified NPLs.

For the rest of 2017, we expect the bank's interest income to remain driven by the elevated yields on investment securities and translation impact of FCY interest income as organic loan growth (-2.24% y/y in H1-17) will remain subdued in the course of the year. Also, we expect NIR to remain elevated driven by FX translation gains, trading gains (FX and T'bills), and improvement in the fee income line.

On the opex side, we expect pressure to persist, and further assets deterioration will likely drive cost of risk above 4.0% in FY-17. Based on our last TP of N30.63, implying 27.62% upside from yesterday's close price of N24.00, we have a BUY recommendation on the stock. Our estimates are under review.

Highlight (N'Mn)	H1-2017	H1-2016	Y/Y	Cordros' Estimate	Variance	Q2-2017	Q1-2017	Q/Q	Cordros' Estimate	Variance
Gross Earnings	380,440	214,812	77.10%	299,671	26.95%	232,704	147,736	57.51%	151,935	53.16%
Interest Income	262,257	181,408	44.57%	243,420	7.74%	144,165	118,092	22.08%	125,328	15.03%
Interest Expense	(123,295)	(54,385)	126.71%	(100,078)	23.20%	(75,807)	(47,488)	59.63%	(52,590)	44.15%
Net Interest Income	138,962	127,023	9.40%	143,342	-3.06%	68,358	70,604	-3.18%	72,738	-6.02%
Provisions	(42,398)	(14,232)	197.91%	(14,569)	191.01%	(34,512)	(7,886)	337.64%	(6,683)	416.38%
NIR	118,183	33,404	253.80%	56,251	110.10%	88,539	29,644	198.67%	26,607	232.77%
Operating Income	214,747	146,195	46.89%	185,023	16.06%	122,385	92,362	32.51%	92,661	32.08%
OPEX	(122,564)	(82,914)	47.82%	(99,183)	23.57%	(74,402)	(48,162)	54.48%	(51,021)	45.82%
PBT	92,183	63,281	45.67%	85,840	7.39%	47,983	44,200	8.56%	41,640	15.23%
Taxation	(16,866)	(18,438)	-8.53%	(14,787)	14.06%	(10,165)	(6,701)	51.69%	(8,086)	25.72%
PAT	75,317	44,843	67.96%	71,053	6.00%	37,818	37,499	0.85%	33,554	12.71%

Disclosures.

Analyst:

Oluwasegun Akinwale (*Oluwasegun.akinwale@cordros.com*)

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BUY (OVERWEIGHT) - Over the next twelve months, we expect the stock to return at least 20% above the current market price.

HOLD (NEUTRAL) - Over the next twelve months, we expect the stock to range between <-10% and <+20% from the current market price.

SELL (UNDERWEIGHT) - Over the next twelve months, we expect the stock to be more than 10% below the current market price.

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