

Zenith Bank Plc.

Set for an Impressive FY-2017 Performance, Amid Credit Loss Pressure

ZENITH recorded a 44.57% growth in interest income in H1-17. On our 12.98% estimated assets yield, we believe the run rate will be sustained for the rest of the year, equating to 36.38% y/y growth in interest income to N524.46 billion. The bank's portfolio of investment securities, treasury bills, and quality loan books will be catalysts of the growth in assets yield. We also forecast NIR to surge by 51.16% to N186.60 billion, buoyed by strong trading income, revaluation gains, and marginal write-back of previous provisions. Overall, we forecast a 39.97% growth in gross earnings to N711.06 billion in 2017F. That said, PBT and PAT growth will be muted, owing to the impact of the elevated cost of refinancing maturing FCY obligations, higher impairment provisioning on transportation (specifically the aviation sector), communication and general commerce exposure, and a surge in total operating expenses (opex).

In a bid to meet maturing FCY obligations during the year, ZENITH issued the second tranche of its USD1 billion Global Medium-Term Note Programme established in 2014. The programme was completed in May and the bank successfully raised USD500 million (at a coupon rate of 7.375%, a 113bps premium over the first tranche). The bank's balance sheet as at H1-17 ending reveals that FCY borrowings worth USD593.80 million (KEXIM USD16.44 million, ABSA Bank USD151 million, JP Morgan USD75.05 million, Standard Bank USD273.83 million, First Rand Bank USD6.52 million, Citi Global Markets USD51.96 million, and BACA USD18 million) are due for maturity between May and October 2017. We believe both the Eurobond and the newly secured borrowings during the year (SMBCE USD49.75 million and AFC USD181.9 million) came at higher cost relative to the maturing loans (mostly concessional borrowings) having estimated weighted average rate of 5.15%. Accordingly, and given the continued tight domestic interest rate environment, we expect cost of funds to expand 125 bps y/y to 5.40% in 2017F – translating to interest expense of N235.88 billion. However, we expect the stronger expansion in asset yields will offset the growth in funding cost, thus, we forecast an uptick in net-interest margin by 25 bps to 7.65%.

In H1-17, ZENITH made a 30% provision on its exposure to 9 Mobile (formerly Etisalat Nigeria) which resulted in a surge in credit loss provision (COR rose to 3.6%, from 1.3% in Q1-17 and H1-16) to N42.40 billion. Though we acknowledge the fact that a haircut is eminent on the syndicated exposure to 9Mobile, it is our understanding that most of the provisions booked in H1-17 by ZENITH was on its bilateral loan to the telco and not entirely on its share as a part of the syndicate. Despite the bank restructuring 11.8% of its gross loan in H1-17 (with oil & gas exposure representing 10.1% of the restructured exposure) as well as declassified some power exposure (down to 1.0% from 43.0% in FY-16), NPL still rose to 4.3% (N99.19 billion) from 3.0% (N71.37 billion) in FY-16, as the bank classified 37.6% (vs. 1.5% in FY-16) and 27.4% (vs. 18.5% in FY-16) of its transportation and general commerce exposure as NPL. Overall, for 2017F, we estimate ZENITH's NPL to increase to 4.50%, from 3.00% in FY-16 and 4.30% in H1-17, and cost of risks to rise to 2.68%, translating to a credit loss provision of N77.13 billion in 2017F.

HOLD

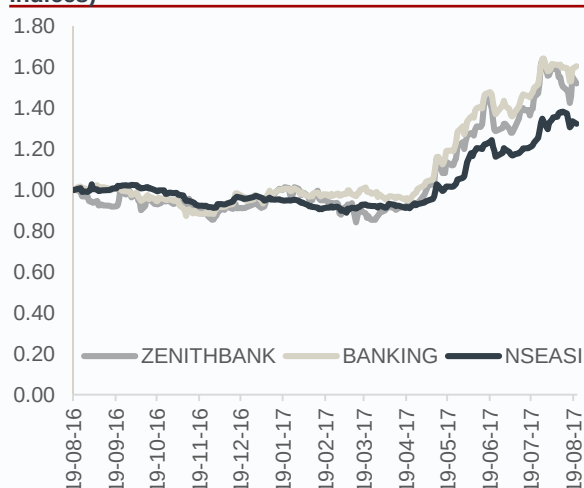
Target Price (N)	27.18
Current Price (N)	24.00
Implied Return (%)	13.26

Company Data

NSE Code	ZENITHBANK
Bloomberg Code	ZENITHBA:NL
Reuters Code	ZENITHB.LG
Sector	FINANCIAL SERVICES
Market Cap. (N'bn)	753.50
Free Float (%)	90.45

Ratios	H1-2017	H1-2016	2016FY
Assets yield	14.7%	11.7%	11.8%
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%

Price movement (ZENITHBANK vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

We estimate opex to rise 29.63% y/y to N226.24 billion in 2017F (driven largely by higher regulatory levies on operating expenses) – translating to a 415 bps y/y expansion in CIR to 56.84% and growth in operational leverage to 4.5x (from 4.0x in FY-16). Accordingly, we expect the impact of the increase in opex to limit the trickling down effect of the rise in gross earnings – we estimate PBT and PAT to rise 9.61% and 8.28% to N171.81 billion and N140.38 billion, respectively.

While acknowledging the impressive performance across income lines in H1-17, which resulted in an upward revision in earnings for the year, we believe the revaluation-bloated growth in NIR will taper in 2018, and factoring in the impact of the adoption of IFRS 9 from 2018 (with management guiding to a 20% impact on credit loss provision and 1% drop in CAR), we now expect PAT to grow lower than previously estimated over 2018F-2019F. Hence, we revise our target price on the stock downward to N27.18 (Previous: N30.63), translating to 13.26% upside from current price of 24.00 (as at 21/08/2017). ZENITHBANK is currently trading at 2017F P/BVPS of 1.0x (above peer average of 0.9x and below the 5-year average of 1.1x) and P/E of 5.6x (above peer average of 5.2x and below the 5-year average of 5.9x). HOLD.

Highlight (N'Mn)	Q1-2017A	Q2-2017A	H1-2017A	Q3-2017F	Q4-2017F	H2-2017F
Gross Earnings	147,736	232,704	380,440	172,658	157,988	330,646
Interest Income	118,092	144,165	262,257	139,927	122,305	262,232
Interest Expense	(47,488)	(75,807)	(123,295)	(54,442)	(58,145)	(112,587)
Net Interest Income	70,604	68,358	138,962	85,485	64,160	149,645
Provisions	(7,886)	(34,512)	(42,398)	(17,085)	(17,648)	(34,733)
NIR	29,644	88,539	118,183	32,731	35,683	68,414
Operating Income	92,362	122,385	214,747	101,131	82,195	183,326
OPEX	(48,162)	(74,402)	(122,564)	(57,607)	(46,068)	(103,675)
PBT	44,200	47,983	92,183	43,524	36,127	79,651
Taxation	(6,701)	(10,165)	(16,866)	(9,666)	(4,896)	(14,562)
PAT	37,499	37,818	75,317	33,858	31,231	65,089

Source: Company Accounts, Cordros Research

A – Actual

F – Forecast

Financial Statement (N'million).

Income Statement (N'M)	2015A	2016A	2017F	2018F	2019F	2020F	2021F
GROSS EARNINGS	432,535	507,997	711,059	740,512	762,832	861,806	936,842
Interest income	348,179	384,557	524,463	579,989	581,322	662,114	717,700
Interest expense	(123,597)	(144,378)	(235,883)	(243,746)	(278,365)	(317,919)	(359,240)
Net interest income	224,582	240,179	288,581	336,243	302,956	344,194	358,460
Non-interest income	84,356	123,440	186,596	160,523	181,511	199,692	219,142
Total Income	308,938	363,619	475,177	496,765	484,467	543,887	577,602
Total Operating Expenses	(167,877)	(174,521)	(226,236)	(211,341)	(215,410)	(246,236)	(262,022)
Net Operating Income	141,061	189,098	248,940	285,424	269,057	297,651	315,580
Loan impairment charges	(15,673)	(32,350)	(77,134)	(98,960)	(74,067)	(88,406)	(101,742)
Profit before Income tax	125,388	156,748	171,807	186,464	194,990	209,245	213,838
Income tax expense	(19,953)	(27,096)	(31,423)	(35,037)	(37,614)	(41,410)	(43,388)
Profit after Tax	105,435	129,652	140,383	151,427	157,376	167,835	170,450
Financial Position (N'M)	2015A	2016A	2017F	2018F	2019F	2020F	2021F
Cash and Cash Equivalents	761,561	669,058	766,293	902,093	970,430	1,077,070	1,209,204
Gross Loans	2,261,507	2,748,822	3,007,417	3,336,200	3,717,814	4,140,482	4,518,396
Assets pledged as collateral	265,051	328,343	337,240	296,384	374,243	458,522	478,543
Treasury Bills	377,928	557,359	688,219	866,438	858,558	849,035	926,165
Investment securities	213,141	199,478	240,636	247,808	277,080	324,842	378,171
Property and equipment	87,022	105,284	118,714	131,332	138,540	152,740	167,464
Total Assets	4,006,842	4,739,825	5,347,471	5,942,644	6,504,224	7,170,907	7,862,182
Total deposits	2,557,884	2,983,621	3,350,593	3,658,990	3,974,264	4,385,202	4,816,941
Other liabilities	205,062	208,680	236,341	242,433	276,216	266,021	312,149
Debt securities issued	99,818	153,464	308,153	279,423	273,508	161,386	149,598
Other borrowed funds	545,743	613,763	557,675	759,790	835,689	1,019,154	1,119,074
Total liabilities	3,412,489	4,035,360	4,545,026	4,998,620	5,416,004	5,911,569	6,476,123
Statutory Reserve	93,093	112,114	116,996	143,492	164,648	224,540	247,134
Total equity	594,353	704,465	802,445	944,024	1,088,220	1,259,338	1,386,059
Key Ratios	2015A	2016A	2017F	2018F	2019F	2020F	2021F
EPS (N)	3.37	4.13	4.47	4.82	5.01	5.35	5.43
P/E (x)	4.82	3.58	6.08	5.72	5.39	7.28	4.13
BVPS (N)	18.93	22.44	25.56	30.07	34.66	40.11	44.15
P/BVPS (x)	0.86	0.66	1.06	0.92	0.78	0.97	0.51
Earnings yield	20.75%	27.90%	16.45%	17.47%	18.54%	13.73%	24.20%
Dividend Paid (N)	1.80	2.02	2.15	2.25	2.30	2.40	2.50
Dividend Yield	11.10%	13.65%	7.91%	8.15%	8.51%	6.17%	11.14%
RoAA	2.72%	2.96%	2.78%	2.68%	2.53%	2.45%	2.27%
RoAE	18.42%	19.96%	18.63%	17.34%	15.49%	14.30%	12.89%
Cost to income	57.24%	52.68%	56.84%	53.13%	52.49%	54.06%	55.06%
Operational Leverage (x)	4.33	3.99	4.49	3.74	3.46	3.60	3.49
Yield on average earning assets	12.50%	11.79%	12.98%	12.83%	11.76%	12.28%	12.16%
Cost of interest bearing liabilities	4.05%	4.15%	5.40%	4.60%	4.80%	5.10%	5.30%
Net Interest Margin	8.04%	7.40%	7.65%	7.86%	6.40%	6.66%	6.35%
Cost of Risk	0.79%	1.43%	3.00%	3.49%	2.32%	2.49%	2.63%
LTD Ratio	88.41%	92.13%	89.76%	91.18%	93.55%	94.42%	93.80%
NPL Ratio	2.18%	3.00%	4.50%	4.00%	3.00%	2.75%	2.50%

Source: Company Accounts, Cordros Research

A – Actual

F – Forecast

Disclosures.

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