

Zenith Bank Plc.

Upward Revision to 2017F Estimates; PAT and PBT to Grow y/y by 28.39% and 30.36%.

In its recently released Q3-17 results, ZENITHBANK reported 35.19% q/q and 8.89% y/y decline in gross earnings, following higher-than-expected contraction in interest income (-30.96% q/q and +4.54% y/y, 28.87% below our estimate) and a steep decline in non-interest revenue (42.07% q/q and 16.29% y/y, ahead of our estimate by 56.71%).

We have cut our gross earnings growth forecast to 35.21% (previously 39.97%) for 2017F to N686.40 billion, on expected lower growth in interest income. That said, following a downward revision of cost of funds and cost of risks, and the expectation of lower opex, we now forecast PBT and PAT growth of 28.39% and 30.36% (previously 9.61% and 8.28% respectively) to N201.85 and N169.01 billion respectively. As a result, our 2017F EPS of N5.38 is now 20.43% higher than the previous estimate.

While we maintain 12.98% (119 bps expansion from 11.79% in FY-16) estimated assets yield, we now expect loan growth to contract 7.09% y/y (previously estimated to grow by 9.41%) in 2017F, equating to 25.42% y/y (previously 36.38% y/y) growth in interest income. On the other hand, we have raised NIR growth to 65.73% (previously 51.16%), buoyed by strong trading income and revaluation gains.

On funding cost, we have revised our 2017F cost of funds lower by 55 bps to 4.85% (+70 bps y/y) translating to 47.44% growth in interest expense to N212.88 billion. Our forecast y/y growth in interest expense reflects the impact of the elevated domestic interest rate environment and the high refinancing costs of maturing FCY obligations via the recently issued Eurobond (at a coupon rate of 7.375%, a 113 bps premium over the first tranche) and borrowings secured during the year. Overall, we look for 9 bps decline in net-interest margin to 7.46%, on faster increase in interest expense over interest income.

Over 9M-17, asset quality deterioration persisted, with NPL ratio rising 200 bps to 4.20% (albeit below the 4.30% in H1-17), while additional provisioning of N4.67 billion in Q3-17 further pushed cost of risk 140 bps higher to 2.70%, following specific provisions on bilateral exposure to Etisalat (now 9 Mobile) and collective allowance for impairment on exposures to the general commerce, transportation, oil & gas, and power sectors. While we acknowledge the restructuring (with oil & gas accounting for a larger proportion) and declassification of some power exposures, however, following the classification of some transportation and general commerce exposures as NPL, we maintain our 2017F NPL estimate of 4.50% and cost of risks of 2.02% (previously 2.68%) – translating to a credit loss provision of N53.56 billion in 2017F.

We estimate opex to rise 25.60% y/y (previously 29.63%) to N219.20 billion in 2017F – translating to a 175 bps y/y contraction in CIR to 46.24% and increase in operational leverage to 4.4x (from 4.0x in FY-16).

HOLD

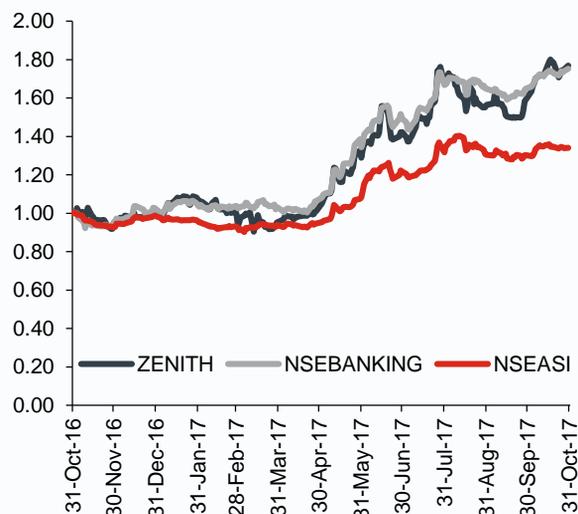
Target Price (N)	30.15
Current Price (N)	26.00
Implied Return (%)	15.96

Company Data

NSE Code	ZENITHBANK
Bloomberg Code	ZENITHBA:NL
Reuters Code	ZENITHB.LG
Sector	FINANCIAL SERVICES
Market Cap. (N'bn)	800.91
Free Float (%)	90.45

Ratios	9M-2017	9M-2016	2016FY
Assets Yield	12.2%	11.5%	11.79%
Cost of funds	5.4%	3.8%	4.2%
Net Interest Margin	7.2%	7.6%	7.4%
Cost of Risk	2.7%	1.3%	1.4%
NPL/Total Loans	4.2%	2.2%	3.0%
CAR	22.2%	19.0%	23.0%
Liquidity Ratio	61.1%	55.2%	59.6%
Cost to Income	52.9%	53.8%	52.7%
Loan to Deposit	64.0%	72.3%	67.8%
cCoverage Ratio	110.3%	126.4%	100.1%

Price movement (ZENITHBANK vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

While acknowledging the possible impact of the adoption of IFRS 9 from 2018F (with management guiding to a 20% impact on credit loss provision and 1% drop in CAR), we believe ZENITHBANK's long position in fixed income securities (treasury bills +69.41% y/y and debt Securities +34.62% y/y) will continue to drive growth in interest income over 2018F. Hence, we revise our target price on the stock higher to N30.15 (Previous: N27.18), translating to 15.96% upside from yesterday's close price of 26.00. **HOLD**

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 4.9x (below peer average of 5.6x and below the 5-year average of 5.9x).

Highlight (N'Mn)	Q1-2017A	Q2-2017A	H1-2017A	Q3-2017A	9M-2017A	Q4-2017F
Gross Earnings	147,736	232,704	380,440	150,826	531,266	155,614
Interest Income	118,092	144,165	262,257	99,532	361,789	120,510
Interest Expense	(47,488)	(75,807)	(123,295)	(37,002)	(160,297)	(52,578)
Net Interest Income	70,604	68,358	138,962	62,530	201,492	67,932
NIR	29,644	88,539	118,183	51,294	169,477	35,104
Operating Income	100,248	156,897	257,145	113,824	370,969	103,036
Provisions	(7,886)	(34,512)	(42,398)	(4,655)	(47,053)	(6,505)
OPEX	(48,162)	(74,402)	(122,564)	(48,800)	(171,364)	(47,835)
PBT	44,200	47,983	92,183	60,369	152,552	48,697
Taxation	(6,701)	(10,165)	(16,866)	(6,451)	(23,317)	(8,923)
PAT	37,499	37,818	75,317	53,918	129,235	39,774

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	686,880	695,375	685,643	740,304	788,505
Interest income	348,179	384,557	482,299	495,878	487,449	527,893	560,772
Interest expense	(123,597)	(144,378)	(212,875)	(215,334)	(213,973)	(236,736)	(253,999)
Net interest income	224,582	240,179	269,424	280,544	273,475	291,157	306,774
Non-interest income	84,356	123,440	204,581	199,497	198,194	212,411	227,733
Total Income	308,938	363,619	474,005	480,041	471,669	503,568	534,506
Total Operating Expenses	(167,877)	(174,521)	(219,199)	(223,434)	(207,190)	(214,986)	(222,322)
Net Operating Income	141,061	189,098	254,806	256,607	264,479	288,582	312,184
Loan impairment charges	(15,673)	(32,350)	(53,558)	(63,249)	(57,131)	(46,792)	(34,280)
Profit before Income tax	125,388	156,748	201,249	193,358	207,348	241,790	277,905
Income tax expense	(19,953)	(27,096)	(32,240)	(33,238)	(35,643)	(41,805)	(45,271)
Profit after Tax	105,435	129,652	169,009	160,119	171,705	199,984	232,634
Financial Position (N'M)	2015A	2016A	2017F	2018F	2019F	2020F	2021F
Cash and Cash Equivalents	761,561	669,058	919,270	1,068,861	1,125,950	1,218,360	1,341,941
Gross Loans	2,261,507	2,748,822	2,553,910	2,673,297	2,767,750	2,904,066	3,057,616
Assets pledged as collateral	265,051	328,343	418,178	276,482	336,226	389,298	404,538
Treasury Bills	377,928	557,359	787,416	923,006	960,021	1,060,319	1,137,261
Investment securities	213,141	199,478	271,121	343,483	370,971	411,157	464,935
Property and equipment	87,022	105,284	158,330	129,711	212,153	165,596	212,135
Total Assets	4,006,842	4,739,825	5,295,332	5,566,983	5,926,053	6,296,432	6,777,479
Total deposits	2,557,884	2,983,621	3,305,970	3,413,300	3,570,537	3,723,162	3,940,393
Other liabilities	205,062	208,680	233,194	226,154	248,157	225,859	255,347
Debt securities issued	99,818	153,464	304,049	260,660	245,724	137,021	122,376
Other borrowed funds	545,743	613,763	550,248	708,773	750,796	865,291	915,434
Total liabilities	3,412,489	4,035,360	4,484,496	4,662,978	4,865,818	5,019,091	5,297,651
Statutory Reserve	93,093	112,114	118,220	137,409	160,414	227,750	263,853
Total equity	594,353	704,465	810,837	904,005	1,060,235	1,277,340	1,479,828
Key Ratios	2015A	2016A	2017F	2018F	2019F	2020F	2021F
EPS (N)	3.36	4.13	5.38	5.10	5.47	6.37	7.41
P/E (x)	4.83	3.58	5.60	5.15	5.75	7.42	3.03
BVPS (N)	18.93	22.44	25.83	28.79	33.77	40.68	47.13
P/BVPS (x)	0.86	0.66	1.17	0.91	0.93	1.16	0.48
Earnings yield	20.70%	27.90%	17.85%	19.42%	17.39%	13.47%	33.02%
Dividend Paid (N)	1.80	2.02	2.15	2.25	2.30	2.40	2.50
Dividend Yield	11.10%	13.65%	7.13%	8.57%	7.31%	5.08%	11.14%
RoAA	2.72%	2.96%	3.37%	2.95%	2.99%	3.27%	3.56%
RoAE	18.38%	19.96%	22.31%	18.67%	17.48%	17.11%	16.87%
Cost to income	54.34%	48.00%	46.24%	46.54%	43.93%	42.69%	41.59%
Operational Leverage	4.33	3.99	4.37	4.11	3.61	3.52	3.40
Yield on average earning assets	12.50%	11.79%	12.98%	12.38%	11.66%	11.88%	11.86%
Cost of interest bearing liabilities	4.05%	4.15%	4.85%	4.15%	3.92%	4.15%	4.23%
Net Interest Margin	8.04%	7.40%	7.46%	7.27%	6.68%	6.75%	6.69%
Cost of Risk	0.79%	1.43%	2.44%	2.76%	2.40%	1.87%	1.29%
LTD Ratio	88.41%	92.13%	77.25%	78.32%	77.52%	78.00%	77.60%
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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