

Guaranty Trust Bank Plc.

Upward Revision to 2017F Estimates; PAT and PBT to Grow y/y by 24.31% and 30.39%

In its recently released Q3-17 results, GUARANTY's gross earnings declined by 19.85%y/y and 12.03% q/q (missed our estimate by 24.27%), with PBT (-1.06% y/y and -3.51% q/q) and PAT (-1.34% y/y and -72 bps q/q) consequently coming in lower (missed our estimates by 11.20% and 3.88% respectively). The key driver of the decline in earnings was a significant contraction in NIR (down 72.80% y/y and 52.75% q/q), which more than subdued the 14.21% y/y (and 74 bps q/q) growth in interest income.

We have cut our gross earnings growth forecast to 3.40% (previously 10.70%) for 2017F to N428.70 billion, on expected deeper contraction in NIR. That said, following a downward revision of costs of risk and opex, amid upward adjustment to cost of funds, we now forecast PBT and PAT growth of 24.31% and 30.39% (previously 26.87% and 28.33% respectively) to NGN205.28 and NGN172.49 billion respectively. As a result, our 2017F EPS of N5.86 is now 1.75% higher than the previous estimate.

Reflecting the lower than expected FX revaluation gains which drove a steep contraction in NIR, we have raised our expected contraction in NIR by 38.72% (previously -24.88%) and estimate NIR contribution to gross earnings to drop to 21.25% (previously 24.33%) in 2017F, compared to FY-2016's 35.86%. We maintained our 2017F asset yields estimate of 13.60%, however, following a 2.84% cut back in our forecast average interest earning assets, we now expect interest income to grow by of 27.62% y/y (previously 31.34%) to NGN334.99 billion – reflecting the persisting high yields on interest earning assets.

We raised our cost of fund estimate by 15 bps to 3.30% for 2017F (34 bps y/y uptick from 2.81% in FY-16), resulting in 19.13% y/y (previously 19.77%) growth in interest expense to N79.93 billion, reflecting the relatively tight domestic system liquidity – which has driven upward repricing of deposits – as well as the impact of the US Feds rate hike. However, we expect the impact of the higher funding cost will be marginal on net interest margin, wherein we forecast a 134 bps y/y expansion to 10.35% (previously 10.43%).

We expect a cut back in loan loss provisioning in 2017F on possible restructuring of some NPLs (we maintained NPL of 3.55%) owing to the (1) successful restructuring of exposures across sectors, specifically FCY loan exposures, (2) relative stability in oil production and prices, with attendant impact on oil & gas upstream obligors cash flow, and (3) improved FX availability to manufacturers and oil & gas downstream obligors. Given the ongoing restructuring of Etisalat Nigeria (now 9Mobile) for a possible sale in the interim, we believe a haircut is eminent on the exposure. And while the bank's management guided to a less aggressive impairment provisioning this year, given the c.N60 billion collective impairment booked in the previous year, we have adopted a more conservative approach for provisioning during the year. Hence, we lowered forecast cost of risk to 1.15% (previously 2.15%), translating to a 73.19% y/y decline in impairment charge to NGN17.50 billion in 2017F.

While opex rose 13.06% in 9M-17, following persisting FX translation impact on operating cost, staff cost, and operating lease, it contracted 37.28% q/q and 27.09% in Q3. Accordingly, we have cut our opex growth forecast to 8.57% y/y (previously 15.11%), translating to a cost to income ratio of 35.64% (previously 34.78%) and operational leverage of 3.9x, compared to 33.03% and 4.0x, in FY-16, respectively.

HOLD

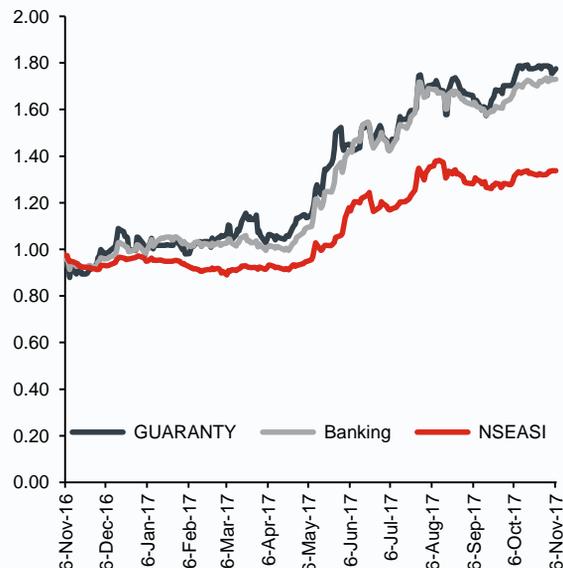
Target Price (N)	42.81
Current Price (N)	41.72
Implied Return (%)	2.62

Company Data

NSE Code	GUARANTY
Bloomberg Code	GUARANTY:NL
Reuters Code	GUARANT.LG
Sector	FINANCIAL SERVICES
Market Cap. (N'bn)	1,227
Free Float (%)	99.76

Ratios	9M-2017	9M-2016	2016FY
Assets Yield	13.69%	11.35%	12.57%
Cost of Funds	3.21%	2.96%	2.81%
Net Interest Margin	10.50%	8.22%	8.12%
Cost of Risk	0.53%	3.66%	4.25%
Cost to Income	37.59%	37.59%	40.76%
Liquidity Ratio	49.75%	37.62%	42.19%
CAR	22.90%	18.10%	19.79%
Coverage	212.72%	185.11%	222.86%
NPL/Total Loans	3.93%	4.13%	3.66%

Price movement (GUARANTY vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

While noting the (1) limited room for any significant growth in FX trading and revaluation gains with the relative stability of the naira and (2) impact of the adoption of IFRS 9 from 2018F, which should drive 49 bps expansion in cost of risk, we believe GUARANTY's long position in fixed income securities will drive growth in interest income over 2018-2019F, with estimated average growth of 7.89%. **We raised our target price marginally by 86 bps to N42.81 (previous: N42.45) and rolled forward our valuation to 2018.**

Our current 12-month TP implies upside potential of 2.62% from current levels; consequently, we recommend a HOLD on the stock. GUARANTY is currently trading at 2017F P/BVPS of 2.1x (above peer average of 1.0x and a 5-year average of 1.9x) and 2017 FP/E of 7.2x (above peer average of 4.9x and a 5-year average of 6.8x).

Highlight (N'Mn)	Q1-2017A	Q2-2017A	H1-2017A	Q3-2017A	9M-2017A	Q4-2017F
Gross Earnings	105,557	108,794	95,704	214,098	309,156	119,540
Interest Income	84,109	81,776	82,385	165,885	248,270	86,715
Interest Expense	(17,980)	(18,367)	(22,357)	(36,347)	(58,704)	(21,225)
Net Interest Income	66,129	63,409	60,028	129,538	189,566	65,490
NIR	20,863	26,637	12,585	46,601	59,186	31,921
Operating Income	86,992	90,046	72,613	176,139	248,752	97,411
Provisions	(3,813)	(3,400)	(1,144)	(7,213)	(8,357)	(9,145)
OPEX	(31,888)	(35,937)	(22,538)	(67,825)	(90,363)	(33,016)
PBT	51,291	50,709	48,931	101,101	150,032	55,250
Taxation	(8,915)	(8,506)	(7,033)	(17,421)	(24,454)	(8,341)
PAT	42,376	42,203	41,898	83,680	125,578	46,909

Financial Statement (N'million).

Income Statement (N'M)	2015A	2016A	2017F	2018F	2019F	2020F	2021F
GROSS EARNINGS	301,851	414,615	428,696	453,354	467,793	495,002	535,032
Interest income	229,237	262,494	334,985	359,188	389,908	409,918	450,571
Interest expense	(69,290)	(67,094)	(79,929)	(78,601)	(81,234)	(94,389)	(99,550)
Net interest income	159,947	195,400	255,056	280,586	308,674	315,529	351,020
Non-interest income	69,535	148,665	91,107	90,954	74,626	81,620	80,779
Total Income	229,482	344,065	346,163	371,541	383,300	397,149	431,799
Total Operating Expenses	(96,379)	(113,638)	(123,379)	(132,289)	(139,636)	(144,441)	(159,225)
Net Operating Income	133,103	230,427	222,784	239,252	243,664	252,708	272,574
Loan impairment charges	(12,408)	(65,290)	(17,502)	(24,491)	(26,439)	(19,834)	(16,109)
Profit before Income tax	120,695	165,137	205,282	214,761	217,225	232,874	256,465
Income tax expense	(21,258)	(32,856)	(32,795)	(37,402)	(38,125)	(39,353)	(39,325)
Profit after Tax	99,437	132,281	172,487	177,359	179,100	193,521	217,140
Financial Position (N'M)	2015A	2016A	2017F	2018F	2019F	2020F	2021F
Cash and Cash Equivalents	254,633	455,863	604,724	691,318	821,476	803,739	854,635
Gross Loans	1,372,978	1,590,084	1,453,715	1,532,962	1,671,710	1,777,599	1,883,554
Assets pledged as collateral	61,954	48,216	60,375	43,865	71,315	92,407	111,590
Investment securities	393,588	528,213	614,188	657,278	624,106	674,779	758,987
Property and equipment	87,989	93,488	97,252	101,066	106,009	117,049	127,088
Total Assets	2,524,594	3,116,393	3,263,487	3,509,227	3,854,886	4,106,996	4,428,163
Total deposits	1,636,606	2,111,314	1,991,391	2,071,571	2,254,498	2,394,073	2,533,362
Other liabilities	104,606	117,747	251,291	188,299	289,647	209,381	237,449
Debt securities issued	180,117	126,238	140,051	197,742	227,275	289,665	314,654
Other borrowed funds	165,123	219,634	255,560	287,170	236,707	283,885	310,537
Total liabilities	2,111,032	2,611,490	2,667,637	2,777,277	3,042,507	3,211,366	3,431,345
Statutory Reserve	165,498	209,185	245,788	309,249	361,103	398,107	443,086
Total equity	413,561	504,903	595,850	731,950	812,379	895,630	996,818
Key Ratios	2015A	2016A	2017F	2018F	2019F	2020F	2021F
EPS (N)	3.38	4.49	5.86	6.03	6.09	6.58	7.38
P/E (x)	4.27	5.68	7.31	7.10	7.04	6.51	5.80
BVPS (N)	14.05	17.16	20.25	24.87	27.60	30.43	33.87
P/BVPS (x)	1.03	1.49	2.11	1.72	1.55	1.41	1.26
Earnings yield	23.40%	17.62%	13.69%	14.08%	14.21%	15.36%	17.23%
Dividend Paid (N)	1.77	2.00	2.30	2.60	2.80	3.00	3.20
Dividend Yield	12.26%	7.84%	5.37%	6.07%	6.54%	7.01%	7.47%
RoAA	4.07%	4.69%	5.41%	5.24%	4.86%	4.86%	5.09%
RoAE	25.24%	28.80%	31.34%	26.71%	23.19%	22.66%	22.95%
Cost to income	42.00%	33.03%	35.64%	35.61%	36.43%	36.37%	36.87%
Operational Leverage (x)	3.95	4.03	3.87	3.91	3.79	3.63	3.73
Yield on average earning assets	12.48%	12.57%	13.60%	12.63%	12.68%	12.45%	12.85%
Cost of interest bearing liabilities	3.43%	2.81%	3.30%	3.18%	3.08%	3.32%	3.25%
Net Interest Margin	8.95%	9.67%	10.35%	9.87%	10.04%	9.58%	10.01%
Cost of Risk	0.93%	4.41%	1.15%	1.64%	1.65%	1.15%	0.88%
LTD Ratio	83.89%	75.31%	73.00%	74.00%	74.15%	74.25%	74.35%
NPL Ratio	3.21%	3.66%	3.55%	3.70%	3.40%	3.00%	2.90%

Source: Company Accounts, Cordros Research

A – Actual,

F – Forecast

Disclosures.

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