

26 October 2018

# Zenith Bank Plc.

## Valuation outlook gets boost from lower cost of funds, despite weak income lines

**Update: We resume coverage of ZENITHBANK with a BUY rating, following the bank's impressive Q3 performance.** Our positive outlook for the group's 2018FY earnings is hinged on (1) lower cost of funds and (2) lower impairment charges. On the flip side, declines across major revenue lines, especially in H1, are expected to weigh on the bank's FY earnings.

**Trimmed deposits to sustain the drop in CoF:** Deliberate efforts by management to ensure a low-cost deposit-mix by cutting off expensive deposits during the year is expected to improve the bank's cost of funds (CoF). Many of the deposits, in 9M-18, were repriced downward. For example, in H1, management had stated during the conference call that interest paid on USD deposits had reduced to the 4-5% range, as against a range of 6-7% previously. Compared to FY-17, expensive fixed and domiciliary deposits were down 24% and 15% respectively in 9M-2018, while focus shifted to growing cheaper savings (+20%) deposits. This resulted in a drop in CoF (-198 bps to 3.26%) in the 9-month period, vs FY-17, while interest expense was down 31% y/y. Management guided towards maintaining the trend going forward, hence our forecast of 2.63% dip in customer deposits by 2018E – contrary to management's guidance to 5% growth in deposits by FY. Overall, we forecast CoF of 3.44% (-180 bps y/y) and interest expense of NGN156.34 billion (-28% y/y) in 2018E.

**Lower impairment provisions:** Similar to tier 1 peers, significantly lower impairment charge has been the trend so far this year, supporting growth in the bottom line. With forecast cost of risk of 1% in 2018E (vs. 4.36% in FY-2017) and projected 12% y/y decline in customer loans (as against management's guidance of 2.5% increase), impairment charge provision is estimated to be 78.6% lower in 2018E than FY-2017 (9M-2018: -70% y/y). Our view of ZENITHBANK's improved asset quality is supported by the improved servicing of debts by obligors, as well as the concluded sale of 9mobile's assets – for which 50% provision has been made. In addition, it is worth stating that considering the historically higher provisions made in Q4, as well as expected loan growth in Q4(+2%) – following management's guidance to explore opportunities in the CBN's new DCRR directive – we estimate a 46% q/q rise in loan loss provisions.

**Weak growth forecast across income lines:** We forecast 11% y/y decline in gross earnings for 2018E, driven largely by our estimated 33% y/y decline in non-interest income (NIR). Our projected drop in NIR stems from expected declines in trading income (-55%) and other income (-30%), which are likely to offset the 14% estimated growth in fee and commission income. In line with management's guidance, trading income is expected to normalize through the rest of the year, and as such, no excessive gain is expected on that line this year. Meanwhile, the significant growth seen across e-product platforms – Zenith mobile (+138%) and USSD (+161%), in particular – in H1 is expected to buoy the growth in fees and commission, even as the bank deepens its retail banking business.

On the other hand, interest income is expected to grow by 1% y/y in 2018E. The 11% y/y and 28% q/q growth in Q3 interest income supports our upbeat view for interest earnings over the rest of Q4. In particular, growth in interest on government securities is expected to buoy growth in the interest income line, offsetting the impact of the 7.65% dip in interest earned on loans (which constitutes 60% of total interest income).

**Estimate and valuation:** Overall, net impact of the updates to our model is a 12% y/y growth in 2018E EPS to NGN6.32, and a TP of NGN33.99. We roll forward estimates and valuation to 2019E, with BUY rating, on 42% upside and expected total return of 51%, after incorporating our 2018E dividend yield of 9%. On our estimates, ZENITHBANK trades at forward P/E multiple of 5.4x, below Bloomberg's Middle East Africa peer median multiple of 8.6x.

# BUY

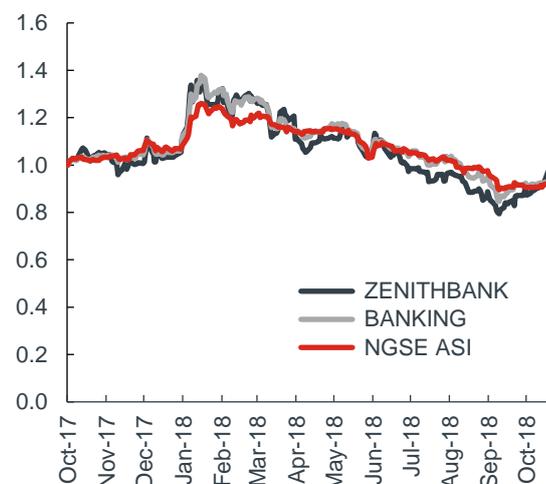
Target Price (NGN)	33.96
Current Price (NGN)	24.00
Implied Return (%)	41.52
Expected Dividend Yield (%)	8.75
Expected Total Return (%)	50.26

### Company Data

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

Ratios	9M-2018	2017FY
Cost of funds	3.35%	3.28%
Net Interest Margin	9.03%	10.50%
Cost of Risk	0.12%	0.76%
NPL/Total Loans	5.57%	7.66%
CAR	22.03%	25.68%
Liquidity Ratio	43.86%	47.56%
Cost to Income	50.11%	42.92%
Loan to Deposit	48.21%	58.91%

### Price movement (ZENITHBANK vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

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## Summary of Results.

Highlights (NGN'bn)	9M'18	9M'17	y/y	Q3'18	Q2'18	Q1'18	Q3'17	Q3'18 q/q	Q3'18 y/y
Gross earnings	474.61	531.27	-11%	152.40	153.01	169.19	150.83	0%	1%
Interest income	339.06	361.79	-6%	110.39	86.05	142.62	99.53	28%	11%
Interest expense	(110.55)	(160.30)	-31%	(35.84)	(27.99)	(46.72)	(37.00)	28%	-3%
Net interest income	228.52	201.49	13%	74.56	58.06	95.90	62.53	28%	19%
Fee and commission income	69.97	71.02	-1%	23.26	25.87	20.84	33.27	-10%	-30%
Trading income	52.93	81.81	-35%	16.13	35.10	1.71	16.49	-54%	-2%
Other income	12.64	16.65	-24%	2.63	5.99	4.03	1.54	-56%	71%
Non-interest income	135.54	169.48	-20%	42.01	66.96	26.57	51.29	-37%	-18%
Total operating income	364.06	370.97	-2%	116.57	125.02	122.47	113.82	-7%	2%
Loan impairment charges	(14.34)	(47.05)	-70%	(4.62)	(5.15)	(4.57)	(4.66)	-10%	-1%
Total operating expenses	(182.42)	(171.36)	6%	(52.00)	(66.52)	(63.90)	(48.80)	-22%	7%
Profit before tax	167.31	152.55	10%	59.95	53.36	54.00	60.37	12%	-1%
Income tax expense	(23.13)	(23.32)	-1%	2.49	(18.70)	(6.92)	(6.45)	-113%	-139%
Profit after tax	144.18	129.24	12%	62.44	34.66	47.08	53.92	80%	16%

Source: Company Accounts, Cordros Research estimates

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# Financial Statement (NGN'million).

Income Statement	2016A	2017A	2018E	2019E	2020E	2021E	2022E
Gross earnings	507,997	745,189	660,875	706,051	759,301	840,580	910,909
Interest income	384,557	474,628	478,643	493,891	527,055	593,328	647,686
Interest expense	(144,378)	(216,637)	(156,335)	(163,554)	(189,766)	(208,731)	(223,986)
Net interest income	240,179	257,991	322,307	330,337	337,289	384,596	423,699
Fee and commission income	68,444	90,143	95,433	118,177	129,995	136,495	143,320
Non-interest income	123,440	270,561	182,232	212,160	232,246	247,253	263,223
Total operating Income	363,619	528,552	504,539	542,497	569,535	631,849	686,922
Loan impairment charges	(32,350)	(98,227)	(21,058)	(30,660)	(35,023)	(37,436)	(41,928)
Total operating expenses	(174,521)	(226,864)	(247,224)	(279,386)	(296,158)	(334,880)	(367,504)
Profit before income tax	156,748	203,461	236,257	232,451	238,354	259,533	277,491
Income tax expense	(27,096)	(25,528)	(37,801)	(34,868)	(34,599)	(39,376)	(41,335)
<b>Profit after tax</b>	<b>129,652</b>	<b>177,933</b>	<b>198,456</b>	<b>197,583</b>	<b>203,755</b>	<b>220,157</b>	<b>236,156</b>
Financial Position	2016A	2017A	2018E	2019E	2020E	2021E	2022E
Cash and cash equivalents	669,058	957,663	989,241	1,183,955	1,315,303	1,201,952	1,208,989
Loans and advances to banks	459,457	495,803	640,097	729,711	678,108	754,905	806,641
Loans and advances to customers	2,289,365	2,100,362	1,857,648	2,079,682	2,280,506	2,528,445	2,832,080
Total Loans and Advances	2,748,822	2,596,165	2,497,745	2,809,392	2,958,613	3,283,350	3,638,721
Treasury Bills	557,359	936,817	967,667	934,070	980,774	1,029,812	1,081,303
Investment securities	199,478	330,951	604,873	493,915	515,223	532,954	546,768
<b>Total assets</b>	<b>4,739,825</b>	<b>5,595,253</b>	<b>5,819,063</b>	<b>6,080,921</b>	<b>6,384,967</b>	<b>6,736,140</b>	<b>7,153,781</b>
Deposits from customers	2,983,621	3,437,915	3,347,408	3,538,719	3,715,956	3,827,435	3,942,258
On-lending facilities	350,657	383,034	402,186	424,306	447,855	472,935	499,656
Debt securities issued	153,464	332,931	372,883	186,441	195,763	205,571	-
Other borrowed funds	263,106	356,498	445,623	512,466	589,387	677,913	813,496
<b>Total liabilities</b>	<b>4,035,360</b>	<b>4,773,597</b>	<b>5,004,529</b>	<b>5,066,313</b>	<b>5,351,214</b>	<b>5,584,654</b>	<b>5,656,020</b>
<b>Total equity</b>	<b>704,465</b>	<b>821,658</b>	<b>814,322</b>	<b>1,034,599</b>	<b>1,074,141</b>	<b>1,214,982</b>	<b>1,562,751</b>
Key Ratios	2016A	2017A	2018E	2019E	2020E	2021E	2022E
EPS	4.13	5.67	6.32	6.29	6.49	7.01	7.52
P/E	3.58	4.80	5.37	5.40	5.23	4.84	4.52
Earnings yield	27.90%	20.84%	18.61%	18.53%	19.11%	20.65%	22.15%
Dividend Paid	2.02	2.60	2.97	2.92	3.03	3.27	3.51
Dividend Yield	14%	10%	9%	9%	9%	10%	10%
RoAA	3%	3%	3%	3%	3%	3%	3%
RoAE	20%	23%	24%	21%	19%	19%	17%
Cost to income	48%	43%	49%	52%	52%	53%	54%
Operational Leverage	3.99	4.39	4.33	4.70	4.75	5.10	5.29
Asset Yield	11.79%	12.29%	11.06%	10.75%	10.82%	11.26%	11.31%
Cost of Fund	3.98%	5.24%	3.44%	3.56%	3.95%	3.20%	3.00%
NIM	7.36%	6.22%	7.45%	7.19%	6.92%	7.30%	7.40%
Cost of Risk	1.37%	4.36%	1.00%	1.30%	1.35%	1.30%	1.30%
LTD Ratio	76.73%	61.09%	55.50%	58.77%	61.37%	66.06%	71.84%

# Disclosures.

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