

No major threat to earnings in the near term; Buy recommendation maintained

Zenith Bank's FY 2019 audited numbers showed a decline in yield on Loans to customers and on money market instruments, however, impressive growth in Non-Interest Income supported profit growth. FY 2019 Return on Average Equity (ROAE) of 23.8% compares with 24.3% for FY 2018. Though we expect Income will be impacted in the first half of the year due to the Covid-19 restrictions and have revised down our estimates accordingly, we expect this to be minimally offset by growth in some electronic banking lines.

Asset quality also remains strong with an NPL ratio of 4.3%, Cost of Risk (COR) 1.1% and coverage ratio of 148% as at FY 2019. We do not expect a significant deterioration in asset quality in the near term. Though we expect a strain in FCY loans following the reduction in oil prices and elevated risks to devaluation in the local currency, we expect that many of such loans will be restructured and their tenors elongated in the near term. We estimate COR of 1.3% for FY 2020e.

Zenith's FY 2019 Capital Adequacy Ratio (CAR) of 22% (without the full impact of IFRS 9) remains comfortably above regulatory minimum of 15.0% currently. The bank has c.39% of gross loans in foreign currency. We estimate that a 20% devaluation in the currency will result in a 45bps decline in the Nigerian bank's 2020e CAR to 19.55% from 20.00% currently.

We find the valuation of the shares compelling (PBV: 0.47x, PE: 2.1x) and though we expect income growth to be challenged owing to the Covid-19 pandemic and the fragile economic conditions, we see no major disaster in view. The bank rates well relative to peers based on capital sufficiency, asset quality and sustainable long-term dividend yield. We maintain a Buy recommendation on the stock and a revised price target of N30.85/s from N36.37/s previously. Downside risks to our forecasts are worsening macro conditions and an extended lock down period beyond Q2.

FY 2019 Nm

	FY 18	FY 19	change	CSL estimate	Variance	Q3 19	Q4 19	change
Interest income	440,052	435,563	-6%	423,292	-2%	107,337	93,625	-12.8%
Interest expense	-144,458	-148,532	-3%	-143,266	4%	-35,225	-41,221	-17.0%
Net interest income	295,594	267,031	-10%	280,026	-5%	72,112	52,404	-27.3%
Fee and commission income	81,814	100,106	22%	102,193	2%	20,218	26,259	29.9%
Other income	98,149	132,014	35%	109,822	20%	26,807	49,105	83.2%
Impairment Charge	-18,372	-24,032	-31%	-25,832	-7%	-4,524	-5,773	-27.6%
cost of risk	0.9%	1.1%	17bps	1.2%	-13bps			
Operating expenses	-225,500	-231,825	-3%	-237,475	-2%	-50,108	-54,884	-9.5%
cost to income ratio	47.4%	46.4%	-97bps	48.3%	-182bps	42.1%	43.0%	90bps
PBT	231,685	243,294	5%	228,734	6%	64,505	67,111	4.0%
Tax	-38,261	-34,451	-10%	-38,885	-11%	-2,665	-8,991	-237.4%
Net Profits	193,424	208,843	8%	189,849	10%	61,840	58,120	-6.0%

Source: Company, CSL Research.

Recommendation

Buy

Target Price

N30.85

Closing Price

N14.00

*Price as at 09 April

Key data

Year to March, Nbn	2018	2019	2020e	2021e
Net Interest Inc	295.6	267.0	258.1	298.7
Operating Inc	475.5	499.2	547.0	588.2
Net Profits	197.5	208.8	192.7	221.9
EPS, N	6.29	6.65	6.14	7.07
PE Ratio	2.2	2.1	2.3	2.0
P/BV(x)	0.54	0.47	0.41	0.35
Dividend yield	19.6%	20.0%	20.0%	20.7%
Market cap.	N439.6bn (US\$1.16bn)			
Free float	99.8%			
Bloomberg	ZENITH NL			
Reuters	ZENITH .LG			

Three-year graph

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Profitability: Interest Income declined 6% y/y to N415.6bn in its reported FY 2019 numbers, owing largely to lower Interest earned on Loans and advances to Customers (down 15% y/y) and Treasury bills (down 19% y/y)- we attribute the decline in both line items to the lower yield environment in 2019 compared to the prior year. Interest Expense however grew moderately, up 3% y/y despite a 5% y/y growth in Interest Bearing Liabilities resulting in a marginal decline in cost of funds, which declined to 3.0% from 3.1% in 2018. Overall, Net Interest Margins (NIMs) declined to 8.2% in 2019 from 8.9% in 2018. We have assumed the interest rates will remain depressed for most of 2020, hence, we forecast funding cost will decline further to 2.9% in 2020e, in line with Management guidance. We forecast a further 40bps decline in NIMs to 7.8% in 2020e which compares with Management's 8.0% guidance. Our forecast is based on a low yield environment and Covid-19 restrictions.

Loans and advances: The bank grew loans significantly in 2019, as Net Loans to customers grew 26% y/y. We believe this was driven by the regulatory guideline from the CBN mandating banks to maintain a Loan to Deposit ratio (LDR) of 65% by December 2019 (an upward revision from the initial threshold of 60% to be met by September 2019). The bank guides to 2% gross loan growth but we assume a 4.9% loan growth in 2020e.

Deposit growth: Customer Deposits were up 15.5% y/y in 2019e and the bank guides to only a 2% growth in 2020. We believe banks will not be so keen on increasing deposits given CBN's minimum LDR of 65% and a further reluctance by banks to extend loans given fragile economic conditions. An increase in deposits will most likely result in weakening their loan to funding ratio when loans are not being extended. Consequently, we assume 4.0% deposit growth for FY 2019e.

Update on asset quality: The bank reports relatively healthy asset quality ratios. Impairment charge was up 31% y/y to N24.0bn in FY 2019- we believe this was driven by the significant growth in the bank's loan book particularly in Q3 and Q4 following the apex bank's regulatory guideline on LDR. The bank's Cost of Risk (COR) came in at 1.1%, higher than 0.9% in FY 2018 albeit in line with our estimate of 1.2%. NPL ratio improved from 4.98% in 2018 to 4.30% in 2019, on the back of increased loan base as the quantum of NPLs remained relatively stable at N105.8bn in 2019 compared with N100.5bn in 2018. Coverage ratio of 148% gives some comfort. The bank guides to COR of 1.0% for 2020e but given that a relatively high number of loans were created last year, we believe that some may begin to show signs of weakness this year, making us forecast COR of 1.3% for 2020e. However, we have not taken into consideration the impact of the decline in oil prices on foreign currency denominated loans given that we do not expect to begin to see any deterioration in these loans this year as many will likely be restructured and tenors elongated.

Non-Interest Income:

Fee and Commission Income: Net Fee and Commission Income grew 22% y/y to N100.1bn, on the back of the 1.08x increase in Fees on electronic products, growth in Credit related fees (13% y/y) and Account maintenance fees (up 9% y/y). While we believe fees on electronic products will get a boost from the lockdown and restrictions in movement, we believe other Fee and commission lines like credit related fees will suffer a decline due to expected slow down in loan growth and trade services. All in, we forecast a marginal 0.8% decline in Fees and Commission Income for 2020e as we expect volumes will be ramped on in the second half of the year.

Other Income: The bank reported Trading gains of N117.8bn in FY 2019 compared to N80.2bn in FY 2018-this was driven by the significant increase in T-bills trading

income (up 21% y/y to N114.3bn), further supported by lower Derivative loss (N7.4bn in FY 2019 compared to N16.8bn in FY 2018).

Other Income (Dividend income from equity investments, Gain on disposal of property and equipment, Foreign currency revaluation gain) however declined 21% y/y owing largely to lower FX revaluation gain (N11.5bn in FY 2019 vs N15.3bn in FY 2018).

The bank (Nigeria) is only marginally Net long to the tune of US\$25.4m and so we do not expect significant revaluation gains in 2019e. We estimate only about N1.8bn in revaluation gains with a 20% devaluation.

Operating Expenses: The bank was able to keep a lid on Operating Expenses, reporting a sub-inflationary growth of 3% y/y. This positive, coupled with a marginal increase in Operating Income (up 5% y/y) led to a 97bps moderation in Cost to Income Ratio (ex-provisions) to 46.4% in FY 2019, which came in below our FY 2019e of 48.3%. We applaud the bank's efforts in containing costs despite the presence of cost pressures in the operating environment. We note however that inflationary pressures and expectations of devaluation may negatively impact costs this year albeit marginally as we still expect many banks to continue with cost containment efforts. This makes us forecast FY 2020e CIR ex- provisions of 48.3%.

Capital adequacy ratio (CAR)

Zenith's FY 2019 Capital Adequacy Ratio (CAR) of 22% (without the full impact of IFRS 9) remains comfortably above regulatory minimum of 15.0% currently. The bank has c.39% of gross loans in foreign currency. We estimate that a 20% devaluation in the currency will result in a 45bps decline in the Nigerian bank's 2020e CAR to 19.55% from 20.00% currently.

Dividend

In line with historical precedence, the bank declared a final dividend of N2.50 (same as in the prior year), bringing the total dividend for FY 2019 to N2.80. We forecast total dividend of N2.80/s for 2020e.

Valuation

The bank rates well on the basis of capital adequacy, sustainable long-term dividend yield, and stable asset quality. We maintain a Buy recommendation on the stock with a revised price target of N30.85/s from N36.37/s previously (current price: N14.00/s as at April 09 2019). We arrived at our price target by applying an implied 0.9x PBV to our 2020e BVPS estimate of 34.2/s. Key inputs to our forecasts are a 20.4% cost of equity, risk free rate of 11.5% and a 6.5% risk premium.

Zenith Bank, Income statement

	2012	2013	2014	2015	2016	2017	2018	2019	2020e	2021e	2022e
Gross earnings	307,082	351,470	403,343	432,535	507,997	745,189	630,344	662,251	645,696	706,420	751,636
								-5.6%	-2.0%	12.6%	7.6%
Interest income	221,318	270,538	313,422	348,179	384,557	474,628	440,052	415,563	407,088	458,178	493,215
Interest expense	(64,561)	(70,796)	(106,919)	(123,597)	(144,378)	(216,637)	(144,458)	(148,532)	(149,033)	(159,446)	(163,438)
Net interest income	156,757	199,742	206,503	224,582	240,179	257,991	295,594	267,031	258,054	298,732	329,777
Impairment charge for credit losses	(9,099)	(11,067)	(13,064)	(15,673)	(32,350)	(98,227)	(18,372)	(24,032)	(32,811)	(40,236)	(43,254)
Net interest income after impairment	147,658	188,675	193,439	208,909	207,829	159,764	277,222	242,999	225,243	258,495	286,523
Net fee and commission income	50,480	55,008	70,512	60,904	68,444	82,548	81,814	100,106	104,068	109,860	116,003
Net gains on fin.instr measured at FV through P&L	19,012	5,105	15,877	18,150	28,398	157,974	80,202	117,798	120,154	122,557	125,008
Other income	1,038	4,499	3,532	5,302	26,598	22,444	17,947	14,216	14,387	15,825	17,408
Share of profit of associates	23	118	138	228	0	0	0	0	0	0	1
Operating Income ex impairment charge	218,211	253,405	283,498	293,493	331,269	422,730	457,185	475,119	463,852	506,738	544,943
Operating Income	227,310	264,472	296,562	309,166	363,619	520,957	475,557	499,151	496,663	546,974	588,198
Amortisation of intangible assets	(1,059)	(951)	(728)	(1,239)	(1,435)	(1,631)	(2,399)	(3,078)	(3,540)	(4,071)	(4,681)
Depreciation of property and equipment	(10,307)	(9,766)	(9,087)	(9,188)	(9,679)	(12,428)	(16,648)	(21,436)	(21,674)	(21,674)	(21,674)
Personnel expenses	(52,427)	(59,952)	(72,320)	(67,522)	(69,042)	(64,459)	(68,556)	(77,858)	(82,529)	(88,307)	(94,488)
Operating expenses	(55,826)	(76,527)	(81,567)	(89,928)	(94,365)	(144,893)	(137,897)	(129,453)	(132,042)	(134,683)	(137,377)
Total operating expenses	(119,619)	(147,196)	(163,702)	(167,877)	(174,521)	(223,411)	(225,500)	(231,825)	(239,785)	(248,734)	(258,220)
Cost to income	53%	56%	55%	54%	48.0%	42.9%	47.4%	46.4%	48.3%	45.5%	43.9%
Profit before taxation	98,592	106,209	119,796	125,616	156,748	199,319	231,685	243,294	224,067	258,004	286,724
Profit before taxation from discontinued operations	3,508	4,388	0	0	0						
Taxation	(1,419)	(15,279)	(20,341)	(19,953)	(27,096)	(21,178)	(34,209)	(34,451)	(31,369)	(36,121)	(40,141)
Effective tax rate	1%	14%	17%	16%	17%	11%	15%	14%	14%	14%	14%
Net profits	100,681	95,318	99,455	105,663	129,652	178,141	197,476	208,843	192,698	221,883	246,582

Source: Company, CSL estimates

Zenith Bank, Balance sheet

Balance sheet Nm

	2016	2017	2018	2019	2020e	2021e	2022e
Assets							
Cash and balances with central banks	669,058	957,663	954,416	936,278	955,004	974,104	993,586
Treasury bills	557,359	936,817	1,000,560	991,393	1,001,307	1,011,320	1,021,433
Assets pledged as collateral	328,343	468,010	592,935	431,728	453,314	475,980	499,779
Due from other banks	459,457	495,803	674,274	707,103	728,316	750,166	772,671
Derivative assets held for risk management	82,860	57,219	88,826	92,722	97,528	102,575	107,874
Loans and advances	2,289,365	2,100,362	1,823,111	2,305,565	2,417,421	2,598,728	2,793,632
	15.1%	-8.3%	-13.2%	26.5%	4.9%	7.5%	7.5%
Investment securities	199,478	330,951	565,312	591,097	620,652	651,684	684,269
Reinsurance assets and insurance receivables	0	0	0	1	3	6	10
Investment in subsidiaries	0	0	0	1	3	6	10
Investment in associates	0	0					
Deferred tax assets	6,440	9,561	9,513	11,885	12,412	12,965	13,547
Other assets	37,536	92,494	80,948	77,395	93,031	110,231	129,151
Assets classified as held for sale	0				3	6	10
Investment property	0	0	0	0	3	6	10
Property and equipment	105,284	133,384	149,137	185,216	195,542	205,868	216,196
Intangible assets	4,645	12,989	16,678	16,497	16,630	16,763	16,898
Total assets	4,739,825	5,595,253	5,955,710	6,346,881	6,591,169	6,910,409	7,249,075
Liabilities			7.3%	15.5%	4.0%	5.0%	5.0%
Customers' deposits	2,983,621	3,437,915	3,690,295	4,262,289	4,432,781	4,654,420	4,887,141
Derivative liabilities	66,834	20,805	16,995	14,762	15,500	16,275	17,089
Claims payable	0	0	0	0	3	6	10
Current income tax	8,953	8,915	9,154	9,711	10,379	11,073	11,795
Deferred income tax liabilities	45	18	67	25	26	27	27
Other liabilities	208,680	243,023	231,716	363,764	264,099	281,514	299,801
Liabilities on insurance contracts	0	0	0	0	2	3	4
On-lending facilities	350,657	383,034	393,295	392,871	404,657	416,797	429,301
Borrowings	263,106	356,496	437,260	322,479	348,780	250,847	134,762
Debt securities issued	153,464	332,931	361,177	39,092	39,649	40,206	40,764
Liabilities classified as held for sale	0	0	0	0	3	6	10
Total liabilities	4,035,360	4,783,137	5,139,959	5,404,993	5,515,878	5,671,173	5,820,704
Equity							
Share capital	15,698	15,698	15,698	15,698	15,699	15,701	15,704
Share Premium	255,047	255,047	255,047	255,047	255,047	255,047	255,048
Retained earnings and reserves	267,008	356,837	322,237	412,948	517,583	648,494	800,882
Other reserves	165,729	183,217	221,231	257,439	286,344	319,626	356,613
	703,482	810,799	814,213	941,132	1,074,672	1,238,868	1,428,247
Non controlling interest	983	1,317	1,538	1,538	1,610	1,690	1,778
Total equity	704,465	812,116	815,751	942,670	1,076,283	1,240,558	1,430,025

Source: Company, CSL estimates

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Zenith Bank

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	Buy	Hold	Sell	Not Rated	Total
	0	0	1	0	1
% distribution	0%	0%	100%	0%	

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