

Valuation Summary

- We are of the view that Zenith Bank Plc is a “Buy” with a target price of NGN 33.3, representing an upside of 43.5%, from the current price of NGN 25.3 as of 25th February, inclusive of a dividend yield of 11.1%,
- Zenith Bank is currently trading at P/TBV of 1.1x and a P/E of 5.7x vs an industry average of 1.2x and 7.6x, respectively.

Key Highlights FY'2018

- Zenith Bank Plc upgraded its Mobile App to incorporate QWERTY Banking, which enables users to perform banking transactions while chatting on any social messaging platform. Zenith QWERTY Banking is designed to enable people perform transactions conveniently while conversing with business partners or chatting with friends and loved ones. It supports funds transfers, airtime purchases and bill payments to different merchants without having to log out of the messaging app being used or signing on to a bank transaction supporting application.

Income Statement

- Core earnings per share increased by 8.7% to NGN 6.2 from NGN 5.7 in FY'2017. Performance was driven by a 25.0% decrease in the total operating expenses to NGN 243.9 bn from NGN 325.1 bn in FY'2017, which outpaced a 10.0% decrease in total operating income to NGN 475.6 bn from NGN 528.6 bn in FY'2017,
- Total operating income decreased by 10.0% to NGN 475.6 bn from NGN 528.6 bn in FY'2017. This was due to a 33.5% decrease in Non-Funded Income (NFI) to NGN 180.0 bn from NGN 270.6 bn in FY'2017, despite a 14.6% increase in Net Interest Income (NII) to NGN 295.6 bn from NGN 258.0 bn in FY'2017,
- Interest income decreased by 7.3% to NGN 440.1 bn from NGN 474.6 bn in FY'2017. Consequently, the yield on interest earning assets decreased to 10.9% in FY'2018 from 12.6% in FY'2017,
- Interest expense decreased by 33.3% to NGN 144.5 bn from NGN 216.6 bn in FY'2017. The cost of funds decreased to 3.3% from 5.7% in FY'2017, while the Net Interest Margin increased to 7.3% from 6.9% in FY'2017,
- Non-Funded Income decreased by 33.5% to NGN 180.0 bn from NGN 270.6 bn in FY'2017. The decline in NFI was driven by a 49.2% decrease in trading income to NGN 80.2 bn from NGN 158.0 bn in FY'2017, and a 20.0% decrease in other income to NGN 17.9 bn from NGN 22.4 bn in FY'2017. Fees and commission income also decreased by 9.2% to NGN 81.8 bn from NGN 90.1 bn in FY'2017. The revenue mix shifted to 62:38 funded to non-funded income from 49:51 in FY'2017, with the proportion of NFI to total income declining owing to the faster decline in NFI as compared to the increase in NII,
- Total operating expenses decreased by 25.0% to NGN 243.9 bn from NGN 325.1 bn in FY'2017, largely driven by an 81.3% decrease in impairment loss on financial assets (loan loss provisions) to NGN 18.4 bn in FY'2018 from NGN 98.2 bn in FY'2017. Other operating expenses decreased by 3.4% to NGN 156.9 bn from NGN 162.4 bn in FY'2017. Personnel expenses increased by 6.4% to NGN 68.6 bn in FY'2018 from NGN 64.5 bn in FY'2017,
- The cost to income ratio improved to 51.3% in FY'2018 from 61.5% in FY'2017. Without loan loss provisions (LLP), the cost to income ratio improved to 55.1% in FY'2018 from 80.1% in FY'2017,
- Profit before tax increased by 13.9% to NGN 231.7 bn from NGN 203.5 bn in FY'2017. Profit after tax increased by 8.7% to NGN 193.4 bn in FY'2018 from NGN 177.9 bn in FY'2017,
- Zenith Bank has declared a final dividend of NGN 2.5 per share, translating to a total payout of NGN 78.5 bn, subject to shareholders' approval. This brings the total annual dividend payout to NGN 87.9 bn translating to NGN 2.8 per share,

Balance Sheet

- The balance sheet recorded an expansion with total assets increasing by 6.4% to NGN 6.0 tn from NGN 5.6 tn in FY'2017. This growth was largely driven by a 68.5% increase in investment securities to NGN 0.7 tn from NGN 0.4 tn in FY'2017, coupled with a 6.8% increase in treasury bills to NGN 1.0 tn in FY'2018 from NGN 0.9 tn in FY'2017,
- The loan book contracted by 13.2% to NGN 1.8 tn from NGN 2.1 tn in FY'2017. Placements with other banks increased by 36.0% to NGN 0.7 tn from NGN 0.5 tn in FY'2017,
- Total liabilities rose by 7.7% to NGN 5.1 tn from NGN 4.8 tn in FY'2017, driven by a 7.3% increase in deposits to NGN 3.7 tn from NGN 3.4 tn in FY'2017, and a 15.8% increase in borrowed funds to NGN 0.8 tn from NGN 0.7 tn in FY'2017,
- The faster growth in deposits as compared to the decline in loans led to a decrease in the loan to deposit ratio (LDR) to 49.4% from 61.1% in FY'2017,
- Shareholders' funds decreased, albeit marginally, to NGN 814.2 bn in FY'2018 from NGN 820.3 bn in FY'2017,
- Zenith Bank Plc is currently sufficiently capitalized with a capital adequacy ratio of 25.0%, which is well above the statutory requirement of 16.0%,
- Zenith Bank currently has a return on average assets of 3.3% and a return on average equity of 23.7%.

Key Take-Outs:

1. Zenith Bank recorded a 10.0% decline in operating income over the period, largely due to declining interest income and trading income, occasioned by a challenging operating environment, with the 13.2% contraction of the loan book leading to compressed yields on interest earning assets. However, the Group was able to absorb these shocks by enhancing cost efficiency through optimization of cost of funds as well as their cost of risk and cost to income ratio (CIR), which led to a 25.0% reduction in total operating expenses. The Group hence managed to maintain its profitability position as the cost efficiency strategies begin to bear fruit.

We expect the bank's growth to be further driven by:

- a. Interest Income Growth Initiatives – With the Nigerian economy expected to expand by 2.0% during the year 2019 according to the IMF, the bank is positioning itself to drive financial inclusion in Nigeria as it establishes a foothold in the retail segment. Moreover, the bank seeks to consolidate its leadership position in the retail and corporate segments, which points to potential for growth.
- b. NFI growth strategies – The Group is making efforts to deepen its roots in the retail segment of the banking clientele. This has resulted in a remarkable increase in the volume of transactions across various electronic platforms as well as significant customer acquisitions. This growth in transactions on digital channels continues to support Zenith Bank's value proposition in the retail segment, in a bid to increase fees from e-products and grow retail deposit balances.

Balance sheet Items	FY'2017	FY'2018	y/y change	FY'2018e	Expected y/y change	Variance in Actual Growth vs Expected
Government Securities	936.8	1,000.6	6.8%	997.4	6.5%	(0.3%)
Net Loans and Advances	2,100.4	1,823.1	(13.2%)	2,304.3	9.7%	22.9%
Total Assets	5,595.3	5,955.7	6.4%	6,304.5	12.7%	6.2%
Customer Deposits	3,437.9	3,690.3	7.3%	3,439.3	0.0%	(7.3%)
Total Liabilities	4,773.6	5,140.0	7.7%	5,581.4	16.9%	9.2%
Shareholders Fund's	820.3	814.2	(0.7%)	721.6	(12.0%)	(11.3%)

Balance sheet Ratios	FY'2017	FY'2018	% y/y change
Loan to Deposit Ratio	61.1%	49.4%	(11.7%)
Return on Average Equity	23.4%	23.7%	0.3%
Return on Average Assets	3.4%	3.3%	(0.1%)

Income Statement	FY'2017	FY'2018	y/y change	FY'2018e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	258.0	295.6	14.6%	319.4	23.8%	9.2%
Net non-interest Income	270.6	180.0	(33.5%)	177.9	(34.2%)	(0.8%)
Total Operating income	528.6	475.6	(10.0%)	497.3	(5.9%)	4.1%
Loan Loss Provision	(98.2)	(18.4)	(81.3%)	(66.1)	(32.7%)	48.6%
Total Operating Expenses	(325.1)	(243.9)	(25.0%)	(290.4)	(10.7%)	14.3%
Profits Before Tax	203.5	231.7	13.9%	206.9	1.7%	(12.2%)
Profits After Tax	177.9	193.4	8.7%	170.7	(4.1%)	(12.8%)
Core EPS	5.7	6.2	8.7%	5.4	(4.1%)	(12.8%)

Income Statement Ratios	FY'2017	FY'2018	y/y change
Yield from Interest Earning assets	12.6%	10.9%	(1.7%)
Cost of Funding	5.7%	3.3%	(2.4%)
Net Interest Spread	7.0%	7.6%	0.6%
Net Interest Margin	6.9%	7.3%	0.5%
Cost of Risk	18.6%	3.9%	(14.7%)
Net Interest Income as % of Operating Income	48.8%	62.2%	13.3%
Non-Funded Income as % of Operating income	51.2%	37.8%	(13.3%)
Cost to Income Ratio	(61.5%)	(51.3%)	10.2%