Zenith Bank Plc – H1'2018

9TH August, 2018

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 53.0%, from the current price of NGN 23.55 as of 9th August, inclusive of a dividend yield of 11.5%,
- Zenith Bank is currently trading at P/TBV of 1.0x and a P/E of 6.2x vs an industry average of 1.5x and 9.5x, respectively.

Key Highlights H1'2018

- 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 8.5% to NGN 2.6 from NGN 2.4 in H1'2017. Performance was driven by a 15.1% decrease in the total operating expenses to NGN 140.1 bn from NGN 165.0 bn in H1'2017, which offset a 3.8% decrease in total operating income to NGN 247.5 bn from NGN 257.2 bn in H1'2017,
- Total operating income decreased by 3.8% to NGN 247.5 bn from NGN 257.2 bn in H1'2017. This was due to a decrease of 8.8% in Non-Funded Income (NFI) to NGN 93.5 bn from NGN 118.2 bn in H1'2017, despite a 10.8% increase in Net Interest Income (NII) to NGN 154.0 bn from NGN 139.0 bn in H1'2017,
- Interest income increased by 10.8% to NGN 154.0 bn from NGN 139.0 bn in H1'2017. However, the yield on interest earning assets decreased to 12.2% in H1'2018 from 13.5% in H1'2017 on the back of a 2.8% increase in total interest-earning assets to NGN 3.7 tn from NGN 3.6 tn in H1'2017,
- Interest expense decreased by 39.4% to NGN 74.7 bn from NGN 123.3 bn in H1'2017. The cost of funds decreased to 4.4% from 6.2% in H1'2017, while the Net Interest Margin increased to 7.5% from 7.3% in H1'2017,
- Non-Funded Income decreased by 8.8% to NGN 93.5 bn from NGN 118.2 bn in H1'2017. The decline in NFI was driven by a 43.6% decrease in trading income to NGN 36.8 bn from NGN 65.3 bn in H1'2017, and a 33.7% decrease in other income to NGN 10.0 bn from NGN 15.1 bn in H1'2017. Fees and commission income, however, increased by 23.7% to NGN 46.7 bn from NGN 37.8 bn in H1'2017. The revenue mix shifted to 62:38 funded to non-funded income from 54:46 in H1'2017, with the proportion of NFI to total income declining owing to the faster decline in NFI as compared to NII,
- Total operating expenses decreased by 15.1% to NGN 140.1 bn from NGN 165.0 bn in H1'2017, largely driven by a 77.1% decrease in impairment loss on financial assets to NGN 9.7 bn in H1'2018 from NGN 42.4 bn in H1'2017. Personnel expenses decreased by 3.9% to NGN 34.8 bn in H1'2018 from NGN 36.2 bn in H1'2017. Other operating expenses increased by 10.7% to NGN 95.6 bn from NGN 86.4 bn in H1'2017,
- The cost to income ratio improved to 56.6% from 64.2% in H1'2017. Without LLP, however, the cost to income ratio deteriorated to 52.7% from 47.7% in H1'2017,
- Profit before tax increased by 16.5% to NGN 107.4 bn from NGN 92.2 bn in H1'2017. Profit after tax increased by 8.5% to NGN 81.7 bn in H1'2018 from NGN 75.3 bn in H1'2017,
- Zenith Bank has declared an interim dividend of NGN 0.3 per share, translating to a total payout of NGN 9.4 bn payable on 24th August 2018,

Balance Sheet

- The balance sheet recorded an expansion with total assets increasing by 6.7% to NGN 5.3 tn from NGN 4.9 tn in H1'2017. This growth was largely driven by a 53.2% increase in government securities to NGN 1.4 tn from NGN 0.9 tn in H1'2017,
- The loan book contracted by 14.4% to NGN 1.9 tn from NGN 2.2 tn in H1'2017. Placements with other banks decreased by 11.9% to NGN 0.5 tn from NGN 0.4 tn in H1'2017,
- Total liabilities rose by 7.8% to NGN 4.6 tn from NGN 4.2 tn in H1'2017, driven by a 6.4% increase in deposits to NGN 3.2 tn from NGN 3.0 tn in H1'2017,
- The faster growth in deposits as compared to loans led to a decrease in the loan to deposit ratio (LDR) to 59.2% from 73.5% in H1'2017,
- Gross non-performing loans decreased by 4.3% to NGN 103.4 bn in H1'2018 from NGN 108.1 bn in H1'2017. Consequently, the NPL ratio improved to 4.9% in H1'2018 from 4.7% in H1'2017. Impairment charge on financial assets decreased by 77.1% to NGN 9.7 bn in H1'2018 from NGN 42.4 bn in H1'2017. Consequently, the NPL coverage improved to 229.2% in H1'2018 from 143.4% in H1'2017,
- Shareholders' funds decreased, albeit marginally, to NGN 718.1 bn in H1'2018 from NGN 718.2 bn in H1'2017,
- Zenith Bank Plc is currently sufficiently capitalized with a capital adequacy ratio of 21.0%, which is well above the statutory requirement of 15.0%,
- Zenith Bank currently has a return on average assets of 3.6% and a return on average equity of 25.7%.

Key Take-Outs:

1. Zenith Bank recorded a contraction in the loan book by 14.4% to NGN 1.9 tn from NGN 2.2 tn in H1'2017. This may be attributed to the industry-wide slowdown in loan growth as a result of the economic recession which halted business activities in the country. However, earnings growth remained resilient on the back of increased efficiency evidenced by a reduced cost-to-income ratio, as well as increased fee income due to large transaction volumes from the retail banking segment

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

a. Interest Income Growth Initiatives – With the Nigerian economy expected to rebound during the year, the bank needs to mobilize more of its deposits to issue out as loans as business recovery continues. The bank needs to employ appropriate risk management measures in deploying deposits in form of loans so as to avoid exposure to risky segments of the market and maintain its asset quality.
b. NFI growth strategies – The bank plans on expanding its current agency banking network of 1,000 agents countrywide, in order to cater for the non-banked population. The bank is also a technology-driven entity that is investing in digital banking initiatives that will drive up transaction volumes by offering convenience to customers.