Guaranty Trust Bank Plc

PAC Holdings
RC254413
| A PROPRIETARY INVESTMENT COMPANY |

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Result Meets Expectation as Non-Interest Income Lifts Earnings

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INVESTMENT SUMMARY

In line with our projection, the H1'18 audited report published by Guaranty Trust Bank shows an improvement in its top-line as gross earnings increased by 5.58% to ₦226.63 billion in H1'18 from ₦214.10 billion reported in H1'17. The growth was driven mainly by non-interest income as it improved by 34.30% to ₦64.75 billion in H1'18 (vs. ₦48.21 billion in H1'17). Non-interest income was boosted by significant improvement in fee and commission income, income on financial assets held for trading, gain on disposal of fixed assets, foreign revaluation exchange gain and dividend income and recoveries. However, interest income of the bank reduced slightly by 2.41% to ₦161.88 billion in H1'18 (vs. ₦165.89 billion in H1'17) due to declining interest rates and dip in loan volume. With 17.28% increase in total deposit, interest expense rose by 20.92% to ₦43.95 billion in H1'18 (vs. ₦36.35 billion recorded in H1'17). Non-interest expenses increased by 3.24% to ₦71.02 billion in H1'18 (vs. ₦68.79 billion in H1'17). The increase in non-interest expenses was triggered by increase in fee and commission expense and personnel expenses as they increased by 49.81% and 13.49% respectively. The bank made a lower provision for loan impairment charge as it reduced by 71.83% to ₦2.03 billion in H1'18 billion, from ₦7.21 billion.

With growth in non-interest income, lower impairment charge and lower tax provision, profit after tax increased by 14.22% to ₦95.58 billion in H1'18 from ₦83.68 billion in H1'17. Impressively, 12-month trailing EPS increased by 26.48% to ₦6.20, from ₦4.90 recorded in the previous period. Impressively, the bank rewarded shareholders as it declared an interim dividend of ₦0.30 in H1'18 (vs ₦0.30 in H1'17).). Based on the recent figure released by the company, we upgrade our recommendation to a **BUY** on the company shares at the current price of as ₦36.95 present forward estimate places the company share price at ₦44.75

Fig. 1: Quarterly results highlights

	2Q2018	1Q2018	2Q2017	Q/q Δ	Y/y Δ
Net Int. Income (₦'mn)	60,922	59,730	63,515	2.00%	-4.08%
PBT (₦'mn)	57,008	52,624	50,708	+8.33%	+12.42%
Net profit (₦'mn)	50,912	44,670	42,202	+13.97%	+20.64%

Source: NSE. PAC Research

Price:	
- Current	₦36.95
- Target	₦44.75
Recommendation:	BUY

** As at Monday August 20, 2018*

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-9.33%/+-3.80%
52-week range	₦36.00 - ₦57.00
30-day Average vol.	12,515,780
Shares Outstanding ('mn)	29,431.18
Market Cap. (₦bn)	1,087.48
EPS (₦) - 12months trailing	6.20
DPS (₦) - FY2017	2.70

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	H1'18	H1'17
Net Interest Margin	9.61%	10.42%
Net profit margin	42.17%	39.08%
Equity multiplier	7.14x	6.01x
Cash/ total Assets	23.42%	15.88%

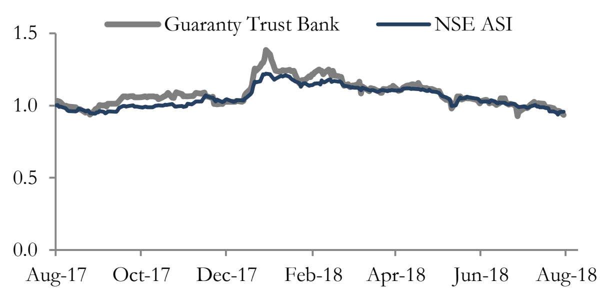
Source: NSE, PAC Research

Fig. 4: Valuation

	FY2017	FY2018E	FY2019E	FY2020E
P/E	6.38x	5.85x	5.18x	5.01x
P/B	1.74x	1.58x	1.52x	1.42x
Div Yield (%)	7.31	7.58	8.12	8.66
Payout Ratio	46.61%	44.31%	42.07%	43.36%
Ev/Revenue	1.85%	1.67%	1.43%	1.27%
Rev per share	14.24	15.17	16.32	17.58
ROE	27.27%	27.07%	29.31%	28.29%
ROA	5.09%	5.26%	5.41%	5.21%

Source: NSE, PAC Research

Fig. 5: GTB vs NSE, 52-wk Movement (Rebased)



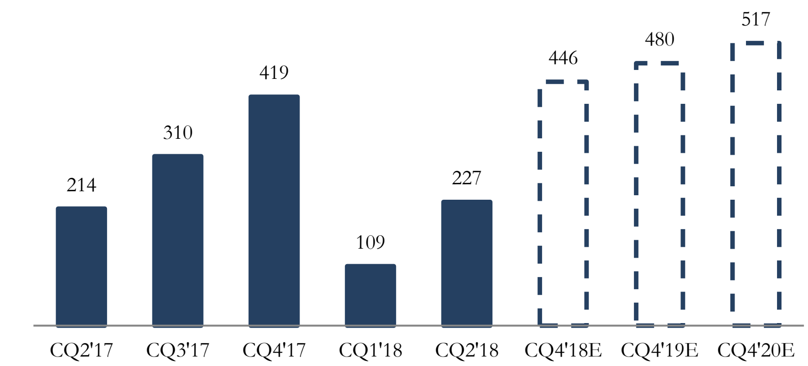
Source: Bloomberg, PAC Research

Gross Earning grows by 5.85% YoY, bolsters by non-interest income

In the period under review, gross earnings improved by 5.85% to ₦226.63 billion, from ₦214.10 billion reported in the first half of 2017. Improvement in the top-line came as a result of significant growth in non-interest income, which compensated for the moderate drop recorded in interest income line. Non-interest income grew by 34.30% to ₦64.75 billion in H1'18 (vs. ₦48.21 billion recorded in H1'17) while interest income recorded a moderate drop of 2.41% to ₦161.88 billion in H1'18 (vs. ₦165.89 billion in H1'17). The increase in non-interest income was strengthened by fee and commission income, foreign exchange trading gain, dividend income and recoveries, gain on disposal of fixed assets, foreign exchange revaluation gain, among others.. However, declining interest rate environment in the first half of 2018, when compared with corresponding period last year, adversely affected interest income from loans and advances. Apart from the declining interest rate environment, there was a reduction in total loans and advances as the bank continues to monitors its non-performing loan ratio.

Improvement in the top-line came as a result of significant growth in non-interest income, which compensated for the moderate drop recorded in interest income line

Fig. 6: Grosss Earnings – Cummulative Quarters CQ2'17-CQ4'20E (Billion NGN)



Source: NSE, PAC Research

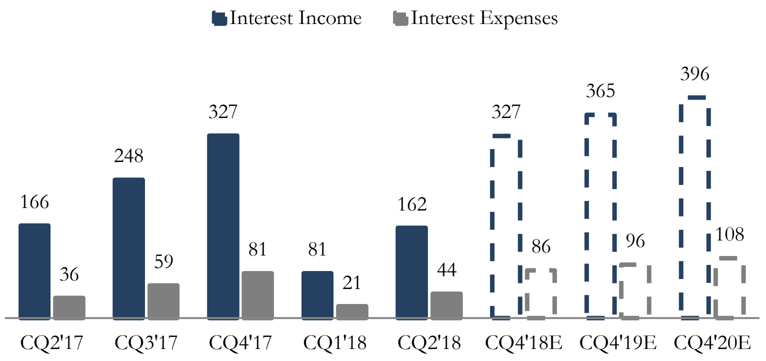
Interest income declines due to declining interest rate environment and dip in loan volume

During the period under review, the bank recorded a moderate reduction in its interest income as it dropped by 2.41% to ₦161.88 billion in H1'18 (vs. ₦165.89 billion in H1'17). The unimpressive performance from interest income can be largely attributed to declining interest rate environment and dip in loan volume in the first half of 2018, when compared with corresponding period last year. Asset yield declined by 143 bps to 13.1% in H1'18 (vs. 14.5% in H1'17) while total loans and advances declined by 13.25% to ₦1.30 trillion in H1'18 (vs. ₦1.49 trillion in H1'17). As a result, interest income from loans and advances to customers declined by 6.90% to ₦97.10 billion in H1'18, from ₦104.29 billion in H1'17.

Asset yield declined by 143 bps to 13.1% in H1'18 (vs. 14.5% in H1'17) while total loans and advances declined by 13.25% to ₦1.30 trillion in H1'18 (vs. ₦1.49 trillion in H1'17)

Due to increase of 17.28% in bank's total deposits in the half year of 2018, total interest expenses increased by 20.92% to ₦43.95 billion in H1'18, from ₦36.35 billion reported in H1'17. Interest expenses on deposit from customers (which accounted for 78.66% of the total interest expenses) increased by 32.65% to ₦34.57 billion in H1'18 (vs. ₦26.07 billion in H1'17). Consequently, net interest income dropped by 8.96% to ₦117.93 billion in H1'18 (vs. ₦129.54 billion in H1'17)

Fig. 7: Interest Income and Interest Expenses: CQ2'17-CQ4'20E (Billion NGN)



Source: NSE, PAC Research

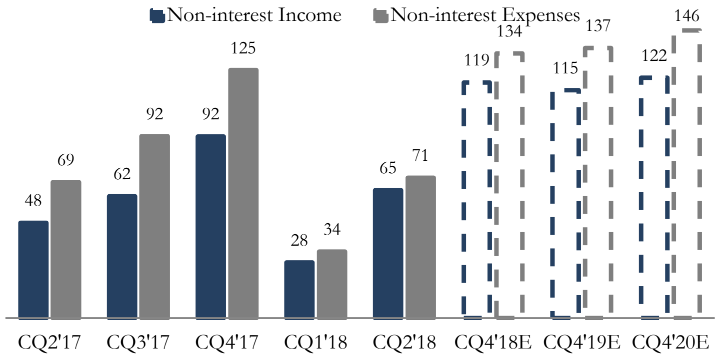
Significant improvement in non-interest income with moderate non-interest expenses

There was a significant improvement in the non-interest income of the bank as it increased by 34.30% to ₦64.75 billion in H1'18 (vs. ₦48.21 billion published in H1'17). The improvement in the non-interest income can be credited to improvement in fee and commission income, net gains on financial instruments classified as held for trading, foreign exchange revaluation gain and dividend income and recoveries. During the period, fees and commission increased by 15.35% to ₦27.36 billion (vs. ₦23.72 billion in H1'17), due to increase in advisory services and transactional volumes stemming from products and service offering via digital channels. Net gains on financial instruments held for trading rose by 123.35% to ₦12.65 billion in H1'18 (vs. ₦5.66 billion achieved in H1'17) as the bank judiciously utilised Naira and Foreign Currency (FCY) liquidity to take appropriate positions in fixed income and FX market. Another impressive performance came from foreign exchange revaluation gain and Dividend income and recoveries as they increased by 20.67% and 2456.16% to ₦17.37 billion and ₦2.72 billion respectively in H1'18. However, there was a moderate increase in non-interest expenses as it increased by 3.24% to ₦71.02 billion in H1'18 (vs. ₦68.79 billion reported in H1'17).

The improvement in the non-interest income can be credited to improvement in fee and commission income, net gains on financial instruments classified as held for trading, foreign exchange revaluation gain and dividend income and recoveries

Personnel expenses increased by 13.49% to ₦18.58 billion in H1'18 (vs. ₦16.37 billion in H1'17), largely from devaluation impact of translating the subsidiaries staff costs from their original currency to Naira as well as impact of bank's salary reviews in January 2018.

Fig. 8: Non-Int. Income and Non-Int. Expense: CQ2'17-CQ4'20E (Billion NGN)



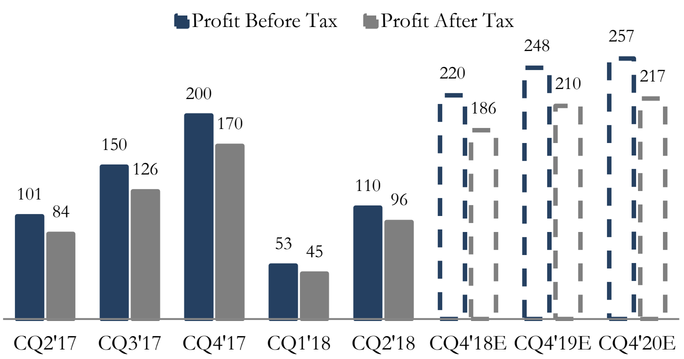
Source: NSE, PAC Research

Lower provision for Loan impairment charges as profit before tax grows by 8.44% YoY

In the first half of 2018, the bank made a lower provision for impairment charges on credit losses as it reduced by 71.83% to ₦2.03 billion in H1'18 (vs. ₦7.21 billion in H1'17). The reduction in loan impairment charges came as a result of adequate provisioning and substantial credit risk buffers created in prior years. With reduction in loan impairment charges, growth in non-interest moderate interest income and moderate increase in costs of fund, profit before tax increased by 8.44% to ₦109.63 billion in H1'18 (vs. ₦101.10 billion in H1'17). The bank made a provision of ₦14.05 billion for tax in H1'18 (vs. ₦17.42 billion in H1'17). As a result, profit after tax increased by 14.22% to ₦95.58 billion in H1'18 (vs. ₦83.68 billion reported in H1'17). The impressive performance in the bottom-line reflected on the twelve months trailing earnings per share as it increased by 26.48% to ₦6.20 from ₦4.90 recorded in the corresponding period of previous year.

With reduction in loan impairment charges, growth in non-interest moderate interest income and moderate increase in costs of fund, profit before tax increased by 8.44% to ₦109.63 billion in H1'18…

Fig. 9: Profit before Tax and Profit after Tax – CQ2'17-CQ4'20E (Billion NGN)



Source: NSE, PAC Research

Improved asset quality with strong coverage for NPLs as the company proposed interim dividend of ₦0.30

The bank recorded a positive growth in its total assets as it rose by 9.80% to ₦3.55 trillion in H1'18 (vs. ₦3.23 trillion in H1'17). However, total liabilities increased by 13.27% to ₦3.05 trillion in H1'18, from ₦2.69 trillion reported in H1'17. Consequently, net assets reduced by 7.61% to ₦497.08 billion in H1'18 (vs. ₦538.00 billion published in H1'17). Due to high non-performing loans experienced in the banking sector in the recent years, the bank continues to monitor its loans and advances as it reduced by 13.25% to ₦1.29 trillion from ₦1.49 trillion recorded in H1'17. Consequently, non-performing loan ratio improved to 5.75% in H1'18 on the back of assets de-recognition made possible by over provisioning and substantial credit risk buffers created in prior years, specifically in 2016 from the huge revaluation gains recorded during that period. Liquidity and Capital Adequacy Ratio of the bank are well above industry requirements of 30% and 15% respectively. Liquidity ratio is 50.33% while capital adequacy ratio of the bank remains at 22.04% in H1'18.

Consequently, non-performing loan ratio improved to 5.75% in H1'18 on the back of assets de-recognition made possible by adequate provisioning and substantial credit risk buffers created in prior years, specifically in 2016…

Fig. 10: Non-Performing Loan by Industry

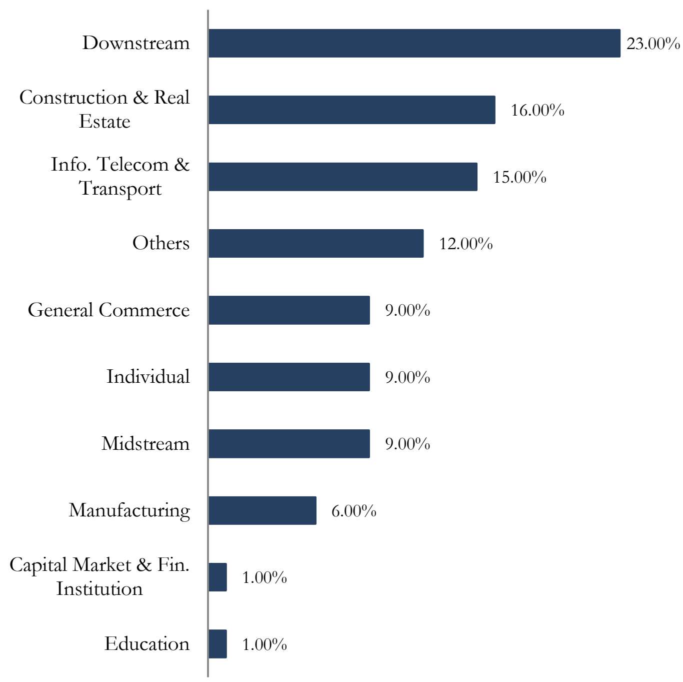
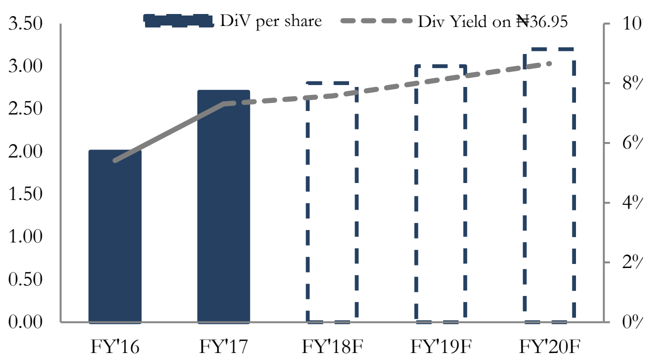


Fig. 11: Dividend Per Share and Dividend Yield (FY'16-FY'20F)



Source: NSE, PAC Research

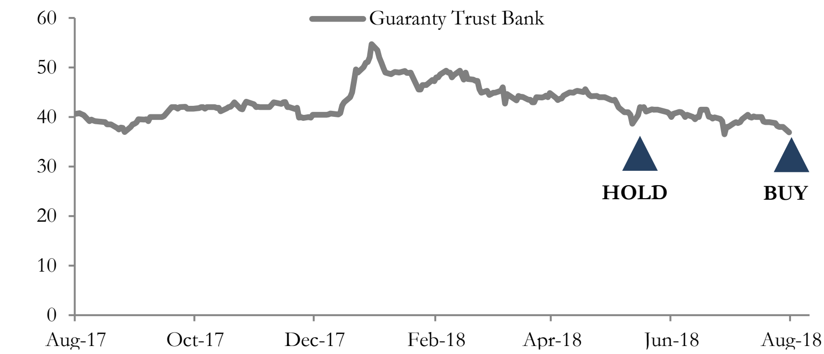
Valuation

Our valuation puts the target price of the stock at ₦44.75, representing an increase of 21.12% from the current price of ₦36.95. In arriving at the target price, we employed Discounted Cashflow Valuation methodology and Residual Income Model. Consequently, we upgrade to a **BUY** recommendation on the stock of the company.

Our valuation and forecasts considered several factors (both quantitative and qualitative) among which are; the previous financial reports of the company, the current figures released by the company and the performance of the bank in the banking industry

Our valuation puts the target price of the stock at N44.75, representing an increase of 21.12% from the current price of N36.95

Fig. 12: Share Price History



Source: NSE, PAC Research

Fig. 13: Statement of Profit or Loss, N'mn

	2016	2017	2018E	2019E
Gross Earnings	414,616	419,226	446,476	480,408
Change		1.11%	6.50%	7.60%
Interest and Similar Income	262,494	327,334	327,267	365,110
Change		24.70%	-0.02%	11.56%
Interest and Similar Expenses	-67,094	-80,670	-85,723	-96,082
Change		20.23%	6.26%	12.08%
Net Interest Income	195,400	246,663	241,544	269,029
Change		26.23%	-2.08%	11.38%
Impairment Charge for credit losses	-65,290	-12,169	-4,911	-5,044
Change		-81.36%	-59.64%	2.71%
Net Fees and Commission Income	35,947	40,732	48,130	55,199
Change		13.31%	18.16%	14.69%
Trade gains	5,218	11,339	20,091	19,216
Change		117.28%	77.19%	-4.36%
Personnel expenses	-29,453	-32,832	-34,825	-31,227
Change		11.47%	6.07%	-10.33%
Profit Before Taxation	165,136	200,242	220,247	247,506
Change		21.26%	9.99%	12.38%
Taxation	-32,856	-29,772	-34,270	-37,646
Change		-9.38%	15.11%	9.85%
Profit After Taxation	132,281	170,470	185,976	209,861
Change		28.87%	9.10%	12.84%

Fig. 14: Statement of Fin. Position, N'mn

	2016	2017	2018E	2019E
Cash and cash equivalents	455,863	641,974	696,503	778,261
Loans and advances	1,590,084	1,449,284	1,459,976	1,570,935
Financial assets held for trading	12,054	23,946	29,914	32,668
-Available for Sale	448,057	517,493	558,095	624,531
Held to Maturity	80,156	96,467	125,013	158,535
Assets pledged as collateral	48,216	58,976	68,802	65,816
Loans and advances to banks	654	750	893	1,057
Loans and adv. to customers	1,589,430	1,448,533	1,459,083	1,569,878
Property and equipment	93,488	98,670	102,868	110,686
Restricted deposits and other assets	371,996	444,947	471,702	515,910
Total Assets	3,116,393	3,351,097	3,535,599	3,881,698
Deposits from banks	125,068	85,431	112,824	115,298
Deposits from customers	1,986,246	2,062,048	2,187,732	2,378,020
Other liabilities	115,682	218,349	170,598	264,224
Deferred tax labilities	17,641	18,076	19,109	20,561
Debt securities issued	126,238	92,132	98,135	105,594
Other borrowed funds	219,634	220,492	235,650	253,559
Total Liabilities	2,611,491	2,725,929	2,848,651	3,165,650
Net Assets	504,903	625,168	686,948	716,048
Total equity and liabilities	3,116,393	3,351,097	3,535,599	3,881,698

Fig. 15: Profitability Ratio

	2016	2017	2018E	2019E
Return on Equity	26.20%	27.27%	27.07%	29.31%
Return on Assets	4.24%	5.09%	5.26%	5.41%
Net interest inc. to rev.	47.13%	58.84%	54.10%	56.00%
PBT margin	39.83%	47.76%	49.33%	51.52%
Net Profit Margin	31.90%	40.66%	41.65%	43.68%
ROCE	7.84%	9.53%	10.19%	10.10%

Fig. 16: Asset Utilisation

	2016	2017	2018E	2019E
Cash/Revenue	109.95%	153.13%	156.00%	162.00%
Revenue to total assets (x)	13.30%	12.51%	12.63%	12.38%
Int. Income / Total Assets	8.42%	9.77%	9.26%	9.41%
Loan Loss Exp/Net Int Inc	33.41%	4.93%	2.03%	1.88%
Loan Loss Exp./PAT	49.36%	7.14%	2.64%	2.40%
fixed asset turnover	22.55%	23.54%	0.62%	0.65%

Fig. 17: Liquidity Ratios

	2016	2017	2018E	2019E
Current ratio	1.19	1.23	1.24	1.23
Cash ratio	0.17	0.24	0.24	0.25
Interest Coverage ratio	2.46	2.48	2.57	2.58
Liquid Assets/Total Deposit	16.74	25.17	19.72	20.95
Loans&Advances/Total Deposit	3.58	6.06	4.95	5.42
Liquid Assets/Total Assets	0.67	0.64	0.63	0.62
Debt/net income	1.66	1.29	1.27	1.21
Debt to asset	0.07	0.07	0.07	0.07
Debt to equity	0.44	0.35	0.34	0.35
Total Liabilities / Total Asset	0.84	0.81	0.81	0.82
Cost to income ratio	0.48	0.24	0.25	0.21
net interest margin	9.61	10.42	0.08	0.08
Total liabilities/equities	5.17	4.36	4.15	4.42

Fig. 18: Shareholders' Investment Ratios

	2016	2017	2018E	2019E
Earnings per share	4.49	5.79	6.32	7.13
DiV per share	2.00	2.70	2.80	3.00
NAVPS	17.16	21.24	23.34	24.33
Earnings yield	12.16%	15.68%	17.10%	19.30%

Fig. 19: Capital Adequacy Ratios

	2016	2017	2018E	2019E
Loans and Advances/Equity	3.15	2.32	2.13	2.19
Equity/Total Assets	0.16	0.19	0.19	0.18
Loan Loss Expense/ Equity	0.13	0.02	0.01	0.01

Source: Company's Annual Reports, PAC Research

Equity research methodology employed in this report

Views documented in this equity research report stem from conclusions reached through the use of multiple valuation methodologies, industry-wide knowledge, company specific information and our near to medium term expectations of industry and company performance, as well as market outlook. Our forecasts are based on a combination of top down and bottom up analysis, alongside historical trends in industry and company financials. Where appropriate, we factored in available forecasts and business direction provided by company management.

Our recommendation tends towards value investing. Therefore, our investment rank gauge—a customized scale we use to judge how well a firm under coverage has performed—is determined using major value parameters as well as relevant ratios and multiples computed with figures from the company's most recent financials.

The variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profit margins, growth, economic viability, gearing, relative valuation ratios, capital structure and management performance. Our investment recommendation is underpinned by the upside or downside potential of a stock under coverage. This potential is estimated by comparing the stock's current market price to its price target and fair value, on a percentage increase or decrease basis as summarized below:

Deviation from current price	Recommendation
>30%	STRONG BUY
10% to < 30%	BUY
-10% to < 10%	HOLD
<-10%	SELL

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