

## Strong Performance from Core Operations Boosts Earnings

### INVESTMENT SUMMARY

The recent Q1'18 audited accounts released by Zenith Bank Plc shows growth of 14.52% in its gross earnings as it increased to ₦169.19 billion (vs. ₦147.74 billion in Q1'17). The growth was majorly triggered by the core operations of the company as the interest income increased by 20.77% to ₦142.62 billion in Q1'18 (vs. ₦118.09 billion in Q1'17). The growth in interest income was boosted by interest income from government securities as the company continue to benefit from high fixed income instruments. However, interest expenses reduced by 1.62% to ₦46.72 billion in Q1'18 from ₦47.489 billion reported in Q1'17. As a result, net interest income increased to ₦95.90 billion in Q1'18 from ₦70.60 billion in Q1'17, representing an increase of 35.83%. The bank made a provision of ₦4.57 billion in Q1'18 (Q1'17: ₦7.89 billion) for impairment charge for credit loss. Due to huge reduction in foreign exchange gain, total trading income reduced by 75.76% to ₦1.71 billion in Q1'18 from ₦7.06 billion reported in Q1'17.

On the back of tremendous increase in interest income, profit before tax increased by 22.17% to ₦54.00 billion in Q1'18 (vs. ₦44.20 billion recorded in Q1'17) while profit after tax increased to ₦47.08 billion in Q1'18 from ₦37.50 billion in Q1'17, representing an increase of 25.55%. The impressive performance led to improvement in earnings per share as it increased by 26.05% to ₦1.50 in Q1'18 (vs. ₦1.19 reported in Q1'17).

The company was able to grow its customer deposits by 13.35% to ₦3.40 trillion in Q1'18 from ₦3.00 trillion in Q1'17 while loans and advances reduced to ₦1.76 trillion in Q1'18 from ₦2.35 trillion in Q1'17, representing a decline of 25.22%.

The current performance of the company is in line with our projection and as a result, we reiterate a **BUY** position on the company shares at current price as present forward estimates places the company share price at ₦33.43

Fig. 1: Quarterly results highlights

	1Q2018	4Q2017	1Q2017	Q/q Δ	Y/y Δ
Gross Earnings (₦mn)	169,192	213,923	147,736	-20.91%	+14.52%
Net Int. Income (₦mn)	95,898	56,499	70,604	+69.73%	+35.83%
Net profit (₦mn)	47,079	48,698	37,499	-3.32%	+25.55%

Source: NSE, Bloomberg, PAC Research

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### Price:

- Current	₦27.45
- Target	₦33.43
<b>Recommendation:</b>	<b>BUY</b>

\* As at Monday April 30, 2018

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+7.06%/+84.23%
52-week range	₦15.00 - ₦34.20
30-day Average Volume	43,776,830
Shares Outstanding ('mn)	31,396.49
Market Cap. (₦bn)	861.83
EPS (₦) - 12months trailing	5.97
DPS (₦) - FY2017	2.70

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	Q1'18	Q1'17
Net Interest Margin	56.68%	47.79%
Net profit margin	27.83%	25.38%
Equity multiplier	7.72x	6.89x
Cash/ total Assets	16.58%	12.75%

Source: NSE, PAC Research

Fig. 4: Valuations

	FY2017	FY2018E	FY2019E	FY2020E
P/E	4.84x	4.48x	4.26x	3.82x
P/B	1.04x	1.04x	1.01x	1.00x
Div Yield (%)	9.84	10.38	11.11	12.02
Payout Ratio	47.64%	46.53%	47.36%	45.87%
Ev/Revenue	1.62%	1.57%	1.43%	1.32%
Rev per share	23.73%	26.35%	30.03%	34.24%
ROE	21.66%	23.26%	23.69%	26.10%
ROA	3.18%	3.26%	3.12%	3.17%

Source: NSE, PAC Research

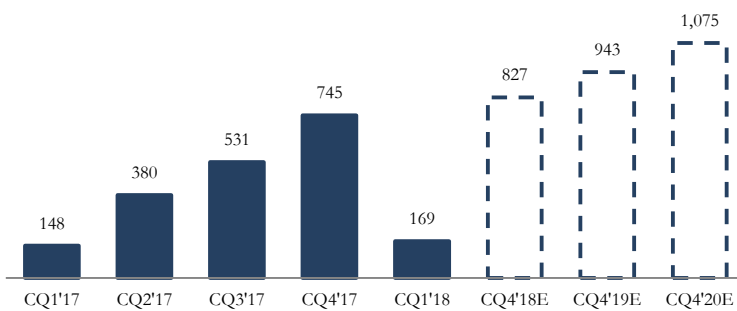
Fig. 5: ZENITH vs NSE, 52-wk Movement (Rebased)



Source: Bloomberg, PAC Research

**Gross earnings increased by 14.52% YoY, boosted by interest income:**

Zenith bank consistently posts a significant YoY growth in gross earnings over the years. The trend continues as the company's gross earnings in Q1'18 increased by 14.52% to ₦169.19 billion (vs ₦147.74 billion in Q1'17) and this was majorly triggered by interest income as it grew by 20.77% to ₦142.62 billion in Q1'18 (vs. ₦118.09 billion published in Q1'17). The growth in interest income was triggered by interest income from treasury bills, government and other bonds, placement with banks and discount houses. However, the performance of non-interest income remains unimpressive as it reduced by 10.69% to ₦26.45 billion in Q1'18 (vs. ₦29.62 billion in Q1'17). The reduction in non-interest income can be largely attributed to reduction in trading income which reduced by 75.76% to ₦1.71 billion in Q1'18 (Q1'17: ₦7.06 billion). Interest income continue to contribute more to the gross earnings as it contributed 84.29% in Q1'18 (vs. 79.93% in Q1'17) while non-interest income contributed 15.71% to gross earnings in Q1'18 (vs. 20.07% in Q1'17).

**Fig. 6: Gross Earnings – Cumulative Quarters CQ'17-CQ4'20E (Billion NGN)**

Source: NSE, Bloomberg, PAC Research

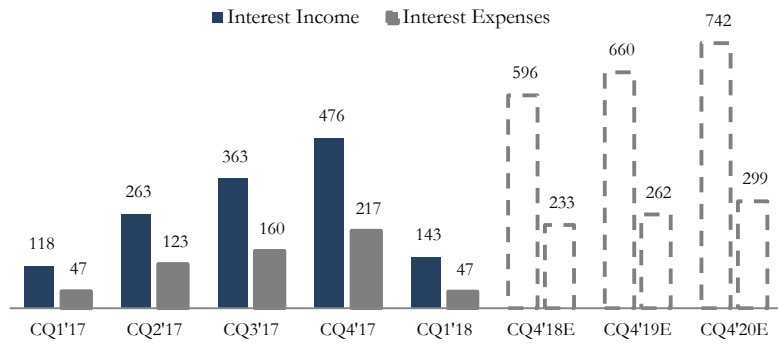
**Impressive Interest income with moderate interest expenses:** The company recorded an impressive performance in its interest income as it grew by 20.77% to ₦142.62 billion in Q1'18 (vs. ₦118.09 billion in Q1'17). The growth in interest income can be credited to the interest income from treasury bills, government and other bonds and placement with banks and discount houses. Interest income from treasury bills increased by 88.86% to ₦50.85 billion in Q1'18 (vs. ₦26.93 billion in Q1'17), interest income from placement with banks and discount houses increased by 92.87% to ₦1.87 billion in Q1'18 (vs. ₦0.97 billion reported in Q1'17) while interest income from government and other bonds rose by 12.51% to ₦12.81 billion in Q1'18 from ₦11.39 billion in Q1'17. Although, interest income from loans and advances to customers reduced by 2.19% to ₦77.08 billion in Q1'18 (vs. ₦78.81 billion in Q1'17), it remains the highest contributor to total interest income as it contributed 54.05% (Q1'17: 66.74%). Interest expenses reduced by 1.62% to ₦46.72 billion in Q1'18 from ₦47.49 billion reported in Q1'17, due to a reduced interest expenses on borrowed funds.

*The growth in interest income was triggered by interest income from treasury bills, government and other bonds, placement with banks and discount houses*

*Although interest income from loans and advances to customers reduced by 2.19% to ₦77.08 billion in Q1'18 (vs. ₦78.81 billion in Q1'17), it remains the highest contributor to total interest income as it contributed 54.05% (Q1'17: 66.74%)*

Interest expenses on borrowed funds reduced by 19.02% to ₦26.60 billion in Q1'18 (vs. ₦32.85 billion in Q1'17). Interest expenses on borrowed fund contributed 56.93% to total interest expenses while interest expenses on savings accounts (Q1'18: ₦4.78 billion), time deposits (Q1'18: ₦12.37 billion) and current accounts (Q1'18: ₦2.96 billion) contributed 10.23%, 26.47% and 6.37% respectively to the total interest expenses. As a result, net interest income increased by 35.83% to ₦95.90 billion in Q1'18 (vs. ₦70.60 billion in Q1'17) while net interest margin stood at 56.68% (Q1'17: 47.79%)

**Fig. 7: Interest Income and Interest Expenses: CQ1'17-CQ4'20E (Billion NGN)**



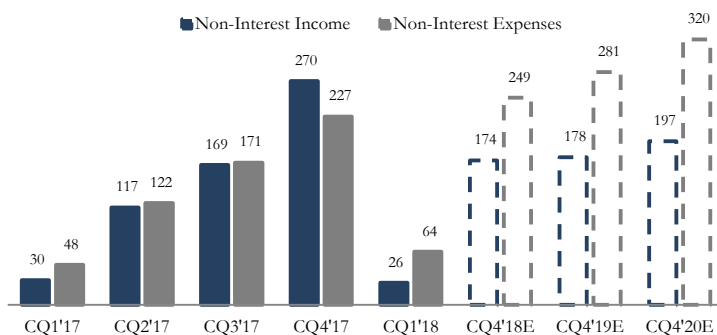
Source: NSE, Bloomberg, PAC Research,

**Non-interest income disappointed as non-interest expenses surged:**

During the review period, non-interest income reduced by 10.69% to ₦26.45 billion from ₦29.61 billion reported in Q1'17. The unimpressive performance from non-interest income can be attributed to a huge reduction in trading income. Trading income reduced by 75.76% to ₦1.71 billion in Q1'18 (vs. ₦7.06 billion reported in Q1'17), due to massive decline in foreign exchange trading income. However, there was a marginal reduction in fee and commission income as it reduced by 1.38% to ₦20.84 billion in Q1'18 (vs. ₦21.13 billion reported in Q1'17). Another major concern lies in non-interest expenses as it increased by 32.67% to ₦63.90 billion in Q1'18 (vs. ₦48.16 billion recorded in Q1'17), mainly as a result of massive increase in operating expenses. Operating expenses increased by 62.71% to ₦43.92 billion in Q1'18 (vs. ₦26.99 billion in Q1'17).

*The unimpressive performance from non-interest income can be attributed to a huge reduction in trading income. Trading income reduced by 75.76% to 1.71 billion in Q1'18...*

**Fig. 8: Non-Int. Income and Non-Int. Expense: CQ1'17-CQ4'20E (Billion NGN)**



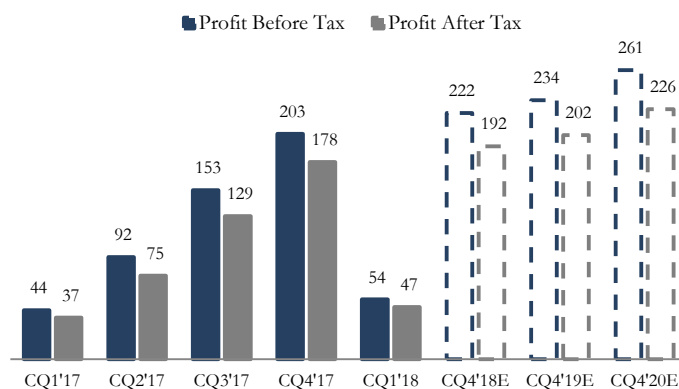
Source: NSE, Bloomberg, PAC Research,

**Less provision for impairment charge for credit loss as bottom line grew by 25.55% YoY:** The bank made a lower provision for impairment charge for credit loss in first quarter of 2018 when compared with corresponding quarter of the previous years. A provision of ₦4.57 billion was made in Q1'18 (Q1'17: ₦7.89 billion) for impairment charge for credit loss. Currently provision for impairment charge on overdraft constitute the larger percentage (90.68%) of the total provision while provision for term loan, which used to be the major contributor, is 9.32% of the total impairment charge on financial assets.

Operating expenses almost pose a threat to the bottom line but with improvement in interest income and lower provision for impairment charge on credit loss, profit before tax grew by 22.17% to ₦54.00 billion in Q1'18 (vs. ₦44.20 billion in Q1'17) while profit after tax increased by 25.55% to ₦47.08 billion (vs. ₦37.50 billion reported in Q1'17). The strong performance of the bank is reflected on its 12 months trailing earnings per share as it increased by 33.26% to ₦5.97 from ₦4.48 recorded in the corresponding previous trailing earnings per share.

*Operating expenses almost pose a threat to the bottom line but with improvement in interest income and lower provision for impairment charge on credit loss, profit before tax grew by 22.17% to ₦54.00 billion in Q1'18...*

Fig. 9: Profit before Tax and Profit after Tax (CQ1'17-CQ4'20E) (Billion NGN)



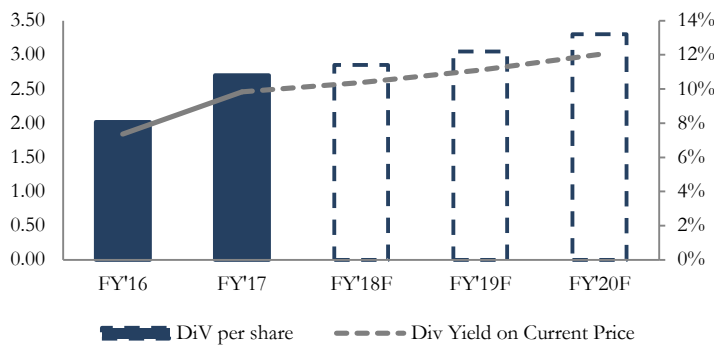
Source: NSE, Bloomberg, PAC Research

**Strong quality capital position of the bank guarantees future dividend payment:** The company increased its total assets by 19.75% to ₦5.68 trillion in Q1'18 (vs. ₦4.74 trillion in Q1'17) while total liabilities increased by 21.93% to ₦4.94 trillion in Q1'18 from ₦4.05 trillion reported in Q1'17. Consequently, net asset increased by 6.89% to ₦735.25 billion in Q1'18 (vs. ₦687.86 billion published in Q1'17). Due to the high non-performing loans experienced in the banking sector in the recent years, the bank continue to monitor its loans and advances as it reduced by 25.22% to ₦1.76 trillion vs. ₦2.35 trillion reported in Q1'17). As a result, non-performing loan ratio remains at 4.30% in Q1'18 (vs. 3.20% recorded in Q1'17). Liquidity and Capital Adequacy Ratio of the bank are well above industry requirements of 30% for liquidity and 15% for capital adequacy ratio.

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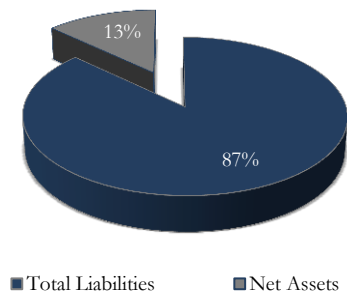
Liquidity and capital adequacy ratio of the bank in Q1'18 are 70.5% (Q1'17: 66.0%) and 22.3% (Q1'17: 21.5%) respectively.

Fig. 10: Dividend Per Share and Dividend Yield (FY'16-FY'20F)



Source: NSE, PAC Research

Fig. 11: Total Liabilities Vs Net Asset in Q1'18



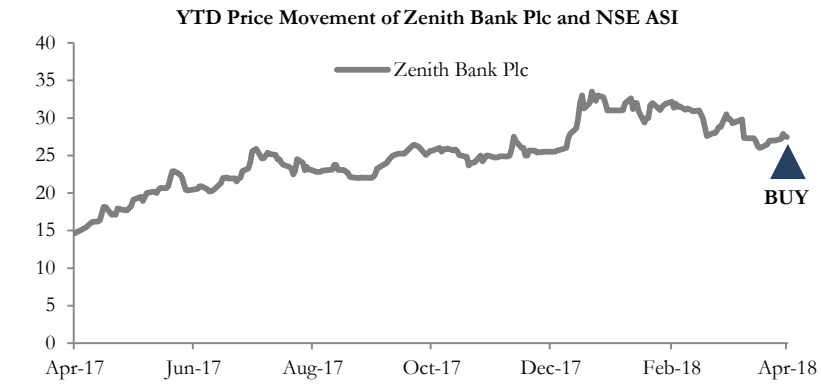
Source: NSE, PAC Research

### Valuation

Our valuation puts the target price of the stock of the bank at ₦33.43, representing an increase of 21.93% from the current price of ₦27.45. In arriving at the target price, we employed Discounted Cashflow Valuation methodology, Dividend Discount Model, Residual Income Model. Consequently, we maintain 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, the performance of the bank in the banking industry, and bright outlook from the management.

*Our valuation puts the target price of the stock of the bank at N33.43, representing an increase of 21.93% from the current price of N27.45*

**Fig. 12: Share Price History**

Source: NSE, PAC Research

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

	2016	2017	2018E	2019E
Gross Earnings	507,997	745,189	827,160	942,962
<i>Change</i>		46.69%	11.00%	14.00%
Interest and Similar Income	384,557	474,628	595,555	660,074
<i>Change</i>		23.42%	25.48%	10.83%
Interest and Similar Expenses	-144,378	-216,637	-233,259	262,143
<i>Change</i>		50.05%	7.67%	12.38%
Net Interest Income	240,179	257,991	362,296	397,930
<i>Change</i>		7.42%	40.43%	9.84%
Impairment Charge for cred	-32,350	-98,227	-64,518	-61,293
<i>Change</i>		203.64%	-34.32%	-5.00%
Fees and Commission Income	68,444	90,143	90,988	89,581
<i>Change</i>		31.70%	0.94%	-1.55%
Trade gains	28,398	157,974	45,494	49,977
<i>Change</i>		456.29%	-71.20%	9.85%
Personnel expenses	-59,326	-64,459	-67,827	-73,551
<i>Change</i>		8.65%	5.23%	8.44%
Profit Before Taxation	156,748	203,461	222,341	233,760
<i>Change</i>		29.80%	9.28%	5.14%
Taxation	-27,096	-25,528	-30,016	-31,558
<i>Change</i>		-5.79%	17.58%	5.14%
Profit After Taxation	129,652	177,933	192,325	202,203
<i>Change</i>		37.24%	8.09%	5.14%

**Fig. 14: Statement of Financial Position, N'mn**

	2016	2017	2018E	2019E
Cash and balances	669,058	957,663	1,038,086	1,183,418
Treasury bills	557,359	936,817	973,733	895,814
Assets pledged as collateral	328,343	468,010	520,366	565,777
Due from other banks	459,457	495,803	537,654	612,925
Derivative assets	82,860	57,219	38,463	43,848
Loans and advances	2,289,365	2,100,362	2,150,615	2,451,702
Investment securities	199,478	330,951	372,222	424,333
Deferred tax assets	6,440	9,561	10,753	12,259
Other assets	37,536	92,494	81,889	94,296
Property and equipment	105,284	133,384	153,025	174,448
Total Assets	4,739,825	5,595,253	5,891,694	6,476,264
Customer deposits	2,983,621	3,437,915	3,556,787	3,913,293
Derivative Liabilities	66,834	20,805	23,078	26,309
Other liabilities	208,680	233,481	264,691	301,748
On lending facilities	350,657	383,034	413,580	499,770
Borrowings	263,106	356,496	392,901	400,759
Debt securities issued	153,464	332,931	405,308	471,481
Total Liabilities	4,035,360	4,773,595	5,064,699	5,622,883
Net Assets	704,465	821,658	826,994	853,381
Total equity and liabilities	4,739,825	5,595,253	5,891,694	6,476,264

**Fig. 15: Profitability Ratio**

	2016	2017	2018E	2019E
Return on Equity	18.40%	21.66%	23.26%	23.69%
Return on Assets	2.74%	3.18%	3.26%	3.12%
Net int. income to Rev.	47.28%	34.62%	43.80%	42.20%
PBT margin	30.86%	27.30%	26.88%	24.79%
Net Profit Margin	25.52%	23.88%	23.25%	21.44%
ROCE	4.71%	5.15%	5.25%	4.90%

**Fig. 16: Asset Utilisation**

	2016	2017	2018E	2019E
Cash/Revenue	131.71%	128.51%	125.50%	125.50%
Revenue to total assets (x)	10.72%	13.32%	14.04%	14.56%
Interest Inc./Total Assets	8.11%	8.48%	10.11%	10.19%
Other Inc./Total Assets	0.56%	0.40%	0.63%	0.58%
Rev. to total fixed assets	482.50%	558.68%	540.54%	540.54%
Fixed asset turnover	20.73%	17.90%	18.50%	18.50%

**Fig. 17: Liquidity Ratios**

	2016E	2017E	2018E	2019E
Current ratio	1.17	1.17	1.16	1.15
Cash ratio	0.17	0.20	0.20	0.21
Interest Coverage ratio	1.09	0.94	0.95	0.89
Liquid Assets/Total Dep.	0.48	0.65	0.67	0.64
Loans & Adv./Total Deposit	0.77	0.61	0.60	0.63
Liquid Assets/Total Assets	0.30	0.40	0.40	0.39
Debt/net income	3.21	3.87	4.15	4.31
Debt to asset	0.09	0.12	0.14	0.13
Debt to equity	0.59	0.84	0.97	1.02
Total Liabilities / Total Asset	0.85	0.85	0.86	0.87
Cost to income ratio net interest margin AVERAGED	0.53	0.53	0.53	0.55
Total liabilities/equities	5.73	5.81	6.12	6.59

**Fig. 18: Shareholders' Investment Ratios**

	2016E	2017E	2018E	2019E
Earnings per share	4.13	5.67	6.13	6.44
Dividend per share	2.02	2.70	2.85	3.05
NAVPS	22.44	26.17	26.34	27.18
Earnings yield	15.04%	20.65%	22.32%	23.46%

**Fig. 19: Capital Adequacy Ratios**

	2016E	2017E	2018E	2019E
Loans and Advances/Equity	3.25	2.56	2.60	2.87
Equity/Total Assets	0.15	0.15	0.14	0.13
Loan Loss Expense/ Equity	0.05	0.12	0.08	0.07

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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