

Making a killing on cheap deposits

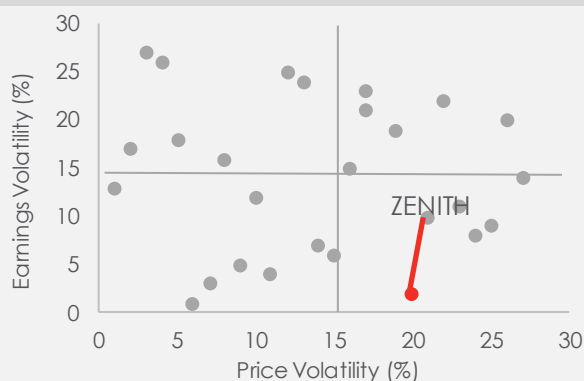
Equity Research | Earnings Update

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Analyst:**Wale Olusi**

+234-8025672325

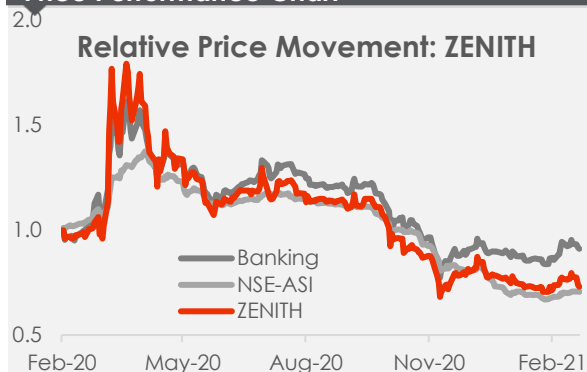
wale.olusi@unitedcapitalplcgroup.com

Risk Rating: Medium

Note: Refer to disclosure appendix for complete description of risk rating

Key Data

Last Price (₦)	17
52 week High/Low (₦)	28.5/10.7
1M Price Change (%)	-0.8
3M Price Change (%)	9.1
6M Price Change (%)	56.1
12M Price Change (%)	37.7
YTD Change (%)	6.1
Beta	1.6
Market Capitalization (₦'m)	825,727.8
Market Capitalization (\$'m)	2014.8
Shares Outstanding. (Units'm)	31396.5
Float (%)	88.2
12M Dividend Yield (%)	12.2

Price Performance Chart

Sources: Bloomberg, United Capital Research

Stock Rating
BUY
Target Price
Old: N29.9
New: N30.4
Upside
15.0%

Zenith Bank Plc ("ZENITH") released its FY-2020 results earlier, reporting a 5.2%y/y growth in Gross Earnings (GE) to N696.5bn. Also, PBT and PAT rose 5.2% and 10.4% to N255.9bn and N230.6bn while Loans and deposits expanded by 19.1% and 25.3% to N3.6trn and N5.3trn respectively. We update our estimates and we review our expectations below.

90bps reduction in CoF bolsters net interest income: ZENITH reported a resilient GE considering the overall pressure on the economy in 2020. The Covid-19 induced macro pressure was reflected in the modest Interest income and non-interest growth numbers which came in at 1.3%/y and 8.5%/y to N420.8bn and N251.7bn, respectively. Interest income was supported by advances to customers relative to a decline in income from investment assets amid a 19.1% expansion in gross loans and advances. Nonetheless, ZENITH's stellar performance is traceable to a significant reduction in interest expense in view of the low interest rate environment, resulting in a 90bps decline in cost of funds (CoF) to 2.1% from 3.0%. Thus, net interest income expanded 12.2% to N299.7bn while Net Interest Margin (NIM) settled at 7.9% (vs. 8.2% in 2019). Also, while fees & commission income tumbled to N79.3bn (from N100.1bn) in 2020, non-interest income growth was supported by a surge in trading income (mainly on Tbills) to N121.8bn (from N117.8bn). Notably, electronic banking fees tumbled from N42.5bn to N27.1bn amid regulatory changes and a reduction in transaction volumes due to the lockdown. However, this was offset by a surge in foreign currency gains and trading income, which surged to N50.7bn from N14.2bn in 2019.

Expectedly, impairment charges printed a 64.5% increase to N39.5bn, driving Cost of Risk (COR) from 1.1% in 2019 to 1.5%. OPEX came in 10.4% higher at N256.0bn, driven mainly by ICT charges (N20.4bn vs N9.8bn), AMCON, NDIC (due to deposit expansion), fuel & maintenance, license, registration and subscription related expenses. Thus, Cost to Income ratio (CIR) increased slightly to 50.0% (vs. 48.8% in the prior period). Accordingly, the profit ratios remained broadly stable as PBT came in at N255.9bn. Thanks to a reduction in the effective tax

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rate from 14.2% in 2019 to 9.9% in 2020, PAT jumped 10.4% to N230.6bn. Thus, net margin settled at 33.1% while ROE and ROA settled at 22.4% and 23.8%.

Sterilized cash accounts for 18.8% of total assets: ZENITH's cash and balances with the CBN jumped 70.0% to N1.6trn, of which over N1.3trn or 83.6% represents mandatory and special reserve deposits with the CBN. This is unsurprising considering a move by the CBN to begin to issue special bills to banks in Q4-2020 as a strategy to manage liquidity as well the apex banks liabilities to deposit money banks going forward. Meanwhile, gross loans and deposits surged 19.2% and 25.3% to N2.9trn and N5.3trn respectively. However, LDR and liquidity ratio of 54.7% and 66.2% reflects a cautious approach to risk-asset creation in view of the fragility of the macroeconomic environment. Again, asset quality concerns appear to be well under control as NPL settled at 4.3% (vs. 5% guideline) with a coverage ratio of 112.1% even as capital adequacy ratio (CAR) improved to 23.0% from 22.0%, compared to the regulatory threshold of 15%/16%.

Robust balance sheet and operating efficiency support a BUY rating: We retain a BUY rating on ZENITH at current price of N26.3/share, buoyed by operational efficiency which was reflected in the reduction in cost of funds, massive cheap deposits and resilient interest income numbers. In 2021, interest income from the huge deposits with the CBN should support earnings considering the special bills offering from the CBN which was executed at 0.5%. For context, we expect PAT to remain stable and well above N200bn in 2021, consolidating its industry position as the most profitable bank. Again, ZENITH's earnings stability continued to more than offset pressure on CAR, as observed in the 2020 numbers. Accordingly, our valuation assumptions feed on the lender's robust balance sheet position, earnings stability, resilient margins and dividend consistency. Adjusting our valuation assumption for higher country risk premium as well as risk free rate, we revised our TP to N30.4/share with a 15.0% upside potential compared to current price. The bank trades at a P/B ratio of 0.7x, less than 1.2x for GUARANTY. Accordingly, we maintain a BUY rating on the ticker.

Contacts

Securities Trading

+234-1-280-7443
securities@unitedcapitalplcgroup.com

Asset Management

+234-1-277-7511
Assetmanage-
ment@unitedcapitalplcgroup.com

Trustees

+234-1-280-7275
Trustees@unitedcapitalplcgroup.com

Investment Banking

+234-1-280-7583
InvestmentBank-
ing@unitedcapitalplcgroup.com

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Financial Highlights (N'Mn)

Headlines	FY 2020	FY 2019	Change
Gross Earnings	696,450	662,251	5.20%
Interest Income	420,813	415,563	1.30%
Interest Expense	-121,131	-148,532	-18.40%
Net Interest Income	299,682	267,031	12.20%
Impairment Charge	-39,534	-24,032	64.50%
Non-Interest Income	251,745	232,120	8.50%
Operating Expenses	-256,032	-231,825	10.40%
Profit/Loss Before Tax	255,861	243,294	5.20%
Taxation	-25,296	-34,451	-26.60%
Profit/Loss After Tax	230,565	208,843	10.40%
	FY 2020	FY 2019	Change
Cash and Balances with Central Bank	1,591,768	936,278	70.00%
Net Loans & Advances	3,589,521	3,012,668	19.10%
Investment Securities	591,097	565,312	4.60%
Total Deposits	5,339,911	4,262,289	25.30%
Total Assets	8,481,272	6,346,879	33.60%
Net Assets	1,117,473	941,886	18.60%
EPS (N)	7.3		
BVPS (N)	35.6		
P/E (x)	3.5		
P/BV (x)	0.7		
Final Dividend	2.7		
Dividend Yield	10.40%		

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Trustees

+234-1-280-7275
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Disclosure Appendix

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Buy: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%). We consider this as the minimum return that may deserve our holding of a risk asset, like equity.

Hold: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater zero but less than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%).

Sell: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at December 31st is less than zero.

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Company	Disclosure
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Flour Mills of Nigeria Plc	g,h
FCMB Plc	h
Fidelity Bank Plc	g,h
Forto Oil Plc	g,h
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