

ZENITH BANK PLC



... Earnings Capacity Restrained by High-Cost Operating Environment

August 31, 2022



Earnings Note

Event

Zenith Bank Plc reported a mixed performance in Q2 2022. Backed by loan book growth and digital banking operations, the Group reported a 13% YoY gross earnings growth to N213.24bn in Q2 2022. Operating income grew by 16% YoY to N157.59bn while operating expenses increased by 19% YoY to N95.58bn. By implication, the Group's cost-to-income ratio in Q2 2022 rose by 200 basis points to 61%.

Nonetheless, profit before tax grew by 11% YoY to N62.01bn. However, profit after tax was flat due to a higher effective tax rate in Q2 2022. This was a consequence of the new tax regulations that removed exemption status on some financial assets.

Loan Book Growth Continue to Drive Earnings

Average loan book expanded by 22% YoY to N3.423trn, a reflection of the Group's strategy to drive earnings growth amid a low-yield environment. The growth in loan books offset the impact of lower average yields on loan book. The situation (of volume offsetting pricing) also played out across the Group's other interest-earning assets (i.e., investment securities).

Meanwhile, while average yields on interest-earning assets were yet to respond to the rising interest rate environment, the Group's cost of funds responded swiftly as interest expense rose by 20% YoY to N31.14bn in Q2 2022. We attribute this increase to the nature of the Group's deposit base which is skewed toward price-sensitive customers.

Momentum Solidifies in Digital Banking

We previously expressed our positive outlook on the Group's digital banking. Net fee and commission income grew by 63% YoY to N30bn in Q2 2022. Trading gains (+13% YoY to N52.59bn) also lifted the Group's income in Q2 2022.

The Impact of Regulatory & IT-related Costs Bite Hard

Operating expenses grew by 19% YoY to N64.94bn. The combination of NDIC, AMCON, fuel and maintenance, and IT-related costs accounted for 83% of total opex growth. While NDIC and AMCON costs were regulatory costs that were tied to balance sheet growth, fuel and maintenance expenses were due to the energy disruptions and heightened domestic inflationary pressures. We attribute IT-related expenses to the Group's intensified efforts to drive growth in its digital banking business as a new source of growth.

The impact of these cost pressures dampened profit growth in Q2 2022. Higher effective tax rates further weighed on the bottomline. Nonetheless, in its usual tradition, the Group declared a N0.30 interim dividend. The qualification and payment dates are September 6, 2022, and September 13, 2022.

Zenith Bank	Q2 2022	Q2 2021	YoY Change	Zenith Bank	Q1 2022	Q1 2021	YoY Change
Gross earnings	213,240	188,250	13%	Gross earnings	184,559	137,510	34%
Net interest income	65,841	60,828	8%	Net interest income	93,780	79,313	18%
Non-interest income	97,898	85,492	15%	Non-interest income	58,175	36,334	60%
Operating income	157,595	136,395	16%	Operating income	151,010	130,514	16%
Operating expenses	(95,581)	(80,358)	19%	Operating expenses	(83,019)	(69,492)	19%
Profit after tax	53,215	53,059	0%	Profit after tax	58,198	53,060	10%

BUY

Fair Value Estimate:
N27.34

Total Return: +39%

Stock Data

Current price (N)	21.95
Shares Outstanding (mn)	31,396
Market Cap (N'mn)	689,142
52-week high (N)	27.50
52-week low (N)	18.90
Trailing EPS (N)	7.79
Forward EPS (N)	8.55
Forward PE (X)	2.57
Justified PE Multiple (X)	3.20



Stock Data

	FY 2020	FY 2021	FY 2022F
P/E	2.99x	2.82x	2.57x
P/BV	0.62x	0.54x	0.47x
PBT Margin	37%	37%	36%
PAT Margin	33%	32%	30%
RoE	22%	20%	19%
Dividend Yield	14%	14%	14%

Analysts

Abdulrauf Bello
a.bello@wstc.com.ng

Isaac Osaro
i.osaro@wstc.com.ng

Oluwadamilola Pase
o.pase@wstc.com.ng

H1 2022 Financial Performance

Income Statement (N'mn)	H1 2022	H1 2021	YoY Change (%)
Gross earnings	405,418	345,559	17%
Interest income	241,726	203,934	19%
Interest expense	(56,983)	(43,994)	30%
Net interest income	184,743	159,940	16%
Impairment charge	(25,122)	(19,799)	27%
Net interest income after impairment	159,621	140,141	14%
Non-interest income	163,692	141,625	16%
Net fee and commission income	64,447	47,664	35%
Trading income	85,192	59,275	44%
Other income	(655)	19,829	-103%
Operating income	308,605	266,909	16%
Depreciation	(13,417)	(12,925)	4%
Amortisation	(1,669)	(1,770)	-6%
Personnel expenses	(39,737)	(37,577)	6%
Other expense	(123,777)	(97,578)	27%
Total expense	(178,600)	(149,850)	19%
Profit before tax	130,005	117,059	11%
Tax	(18,592)	(10,940)	70%
Profit after tax	111,413	106,119	5%
Balance Sheet Information (N'mn)	H1 2022	H1 2021	YoY Change (%)
Assets			
Cash & balances with CBN	1,630,361	1,424,811	14%
Loans and advances to banks	632,014	656,501	-4%
Loans and advances to customers	3,499,021	2,837,445	23%
Investment securities	3,567,167	2,750,513	30%
Others	786,799	846,201	-7%
Total Assets	10,115,362	8,515,471	19%
Deposits from customers	7,152,964	5,770,434	24%
Borrowings	729,818	708,574	3%
Others	960,304	893,016	8%
Total Liabilities	8,843,086	7,372,024	20%
Net Assets	1,272,276	1,143,447	11%

Source: Company Accounts, WSTC Research

Outlook

We marginally raised our EPS projection for FY 2022 to N8.55 (previous: N8.42) to reflect our expectation of asset yield repricing, in view of the rising interest-rate environment. However, we also factored in sustained cost pressures due to the rising inflationary pressures.

In the near term, we continue to see banking sector earnings under pressure due to weak macroeconomic conditions. In the past months, the industry was characterised by low yields and players in the banking industry had to aggressively grow asset volumes to make up for the yield decline. The trend of low yields appears to have reversed, and we expect the rising trend of yields to remain in the near term. However, we see pressures come from other sources, particularly cost pressures. Staff attrition and severe inflationary pressure are the two pain points we identified as profit compressors.

We estimate a N27.34 fair value for the stock, which represents a 3.20x justified P/E. This compares to the stock's 3.30x P/E ratio (based on our computations). At the current market price, we believe that the stock offers a 39% total return. At an earnings yield of 39%, we posit that the stock is attractive. Hence, we recommend a BUY.

Financial Projections

Income Statement (N' mn)	FY 2021	FY 2022F	FY 2023F	FY 2024F	FY 2025F	FY 2026F
Gross earnings	760,524	900,465	1,045,812	1,233,253	1,488,970	1,776,228
Interest income	427,597	517,559	632,372	751,536	923,278	1,133,299
Interest expense	(106,793)	(132,295)	(139,146)	(157,583)	(177,693)	(199,836)
Net interest income	320,804	385,264	493,227	593,953	745,585	933,462
Non-interest income	332,927	382,906	413,439	481,716	565,692	642,929
Operating expense	(289,533)	(342,809)	(398,143)	(469,502)	(566,854)	(676,213)
Impairment charge	(59,932)	(72,057)	(79,050)	(89,679)	(100,551)	(113,403)
Profit before tax	280,374	324,378	391,658	475,299	594,946	730,192
Profit after tax	244,558	268,585	328,209	403,053	504,514	619,203
EPS (N)	7.78	8.55	10.45	12.84	16.07	19.72
DPS (N)	3.10	3.10	3.10	4.52	5.42	6.48
Balance Sheet (N'mn)						
Cash and cash equivalents	1,488,363	1,776,504	1,948,917	2,210,961	2,478,995	2,795,853
Treasury bills	1,764,945	1,856,082	2,036,217	2,310,000	2,590,040	2,921,091
Investment securities	1,303,726	1,032,430	1,132,629	1,284,918	1,440,688	1,624,833
Loan to banks	56,187	113,366	124,368	141,090	158,195	178,415
Loan to customers	3,355,728	4,026,978	4,417,802	5,011,804	5,619,383	6,337,636
Other assets	1,478,894	2,280,314	2,501,622	2,837,981	3,182,028	3,588,745
Total assets	9,447,843	11,085,675	12,161,555	13,796,754	15,469,328	17,446,573
Customer deposits	6,472,054	7,606,990	8,345,259	9,467,333	10,615,053	11,971,838
Other liabilities	1,696,127	1,997,904	2,107,497	2,349,763	2,543,776	2,756,183
Total liabilities	8,168,181	9,604,894	10,452,756	11,817,096	13,158,829	14,728,021
Shareholder funds	1,279,662	1,480,781	1,708,799	1,979,658	2,310,499	2,718,552
BV/Share (N)	40.76	47.16	54.43	63.05	73.59	86.59
Ratio Analysis						
Net interest margin	4.65%	4.79%	5.43%	5.86%	6.52%	7.26%
PAT margin	32.16%	29.83%	31.38%	32.68%	33.88%	34.86%
RoE	20.40%	19.46%	20.58%	21.85%	23.52%	24.63%
RoA	2.73%	2.62%	2.82%	3.11%	3.45%	3.76%
Cost / Income	48.76%	49.25%	48.11%	47.62%	46.82%	46.22%
Loans / Deposit	51.85%	52.94%	52.94%	52.94%	52.94%	52.94%

Source: Company Accounts, WSTC Research



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- Hold Rating: estimated change in price is between -10% and 15% of current market price.
- Sell Rating: estimated change in price is $\leq -10\%$ of current market price.

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WSTC Securities Limited has its registered office at 2, Maitama Sule Street, South-West Ikoyi, Lagos, Nigeria.

Email: research@wstc.com.ng

Website: www.wstc.com.ng

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