

Regulatory Headwinds Constrain Performance

Gross Earnings Float on Non-core Earnings

In the first quarter of 2020, Zenith Bank Plc (**ZENITHBANK**) grew its topline by 5.50% to NGN166.81bn from NGN158.11bn in Q1:2019. This performance was however driven mainly by volatile income lines - derivatives and foreign currency revaluation income - as core income lines came under pressure during the quarter. Despite an impressive 15.85% YoY growth in income from loans, interest income declined by 6.65%, on the back of a steep decline in treasury yields. Non-interest income on the other hand cushioned the effect of the decline in interest income as its contribution to topline increased from 20.65% in Q1:2019 to 27.96% in Q1:2020. Higher prices from the crash in treasury bills yields translated to higher treasury trading income for the bank by 21.18%. Fees and Commission income on the other hand, fell 14.14% to NGN21.28bn due mainly to the regulatory cut in fees chargeable on e-platforms. **The bank's Q1:2020 performance was broadly in line with our overall expectations for earnings in 2020FY. We acknowledge the increased significance of revaluation gains to overall topline given the recent adjustment in the official dollar exchange rate and the continuing pressure on the Naira. Thus, FX revaluation gains may continue to support topline growth. However, a stabilization in Naira may erode this advantage.**

Mixed Cost Fortunes Keep Bottom Line Flattish

ZENITHBANK's Profit After Tax (PAT) flatlined at NGN50.53bn (vs. NGN50.23bn in Q1:2019) due to mixed cost performance in the period. The bank's focus on cheaper funding paid off with a decline in cost of funds to 2.60% (vs. 3.00% in Q1:2019), supported by the low interest rate environment. Nevertheless, net interest margin contracted to 7.70% from 8.90% as the fall in interest expense failed to offset the fall in interest income as noted above. The company's bottom line was pressured by significantly higher impairment charges and operating expenses (OPEX). The increase in impairment charges (+88.95% to NGN3.95bn) is in line with observed industry trend and is consequent on the industry's loan expansion drive and FX devaluation of impaired assets. Elsewhere, the 10.10% uptick in OPEX further increased Cost-to-Income Ratio (CIR) to 52.70% (vs 50.09% in Q1:2019). **Going forward, we expect CIR to trend lower due to lower funding costs and decline in business overheads across branches where physical operations are expected to be minimal as result of a COVID-19-induced decline in business activity level.**

Strong Asset Growth Supported by Retail Drive

Total assets grew by 12.31% YtD to NGN7.13trn, driven by a 19.13% expansion in the loan book to NGN3.59trn. The bank's increased retail penetration is regarded a key enabler of asset growth as it has provided the bank with cheaper funding. This is evident in the continued rebalancing of funding mix in favour of deposits, which grew by 4.70% YtD to NGN4.46tr. Loans-to-Deposit ratio thus settled at 71.70%. However, asset quality worsened slightly to 4.60% from 4.30% in 2019FY. All other prudential ratios are well above regulatory limits.

Outlook and Recommendation

As noted above, the bank's core earnings in Q1:2020 were impaired by regulatory headwinds which have not abated. This challenge is expected to be compounded in the immediate term by the incidence of COVID-19. We therefore adopt a prudent stance on the bank's short-term outlook. We applied a target PE of 2.86x and expected EPS of NGN6.57 to obtain a December 2020 target price of **NGN18.79**. This indicates an upside potential of **20.45%**, hence we rate the ticker a **BUY**.

Company	ZENITHBANK
Valuation	
Trailing EPS	6.66
BVPS	29.49
P/E	2.15x
P/BV	0.48x
Target PE	18.79x
Dec-2020 Exp. EPS	6.57
Dec 2020 Target price	18.79
Current Price	15.60
Up/Downside Potential	+20.45%
Ratings	BUY
Key metrics	
ROE	21.60%
ROA	3.00%
Net margin	30.29%
Asset Turnover	0.13
Leverage	14.54x
Share/Share Price Statistics	
Yr Hi	NGN22.75
Yr Lo	NGN10.70
YTD return	-24.46%
Beta	1.12
Adjusted Beta	1.08
52-wk average volume	25,561,877
Shares outstanding	31.40bn
Market cap [NGN]	448.97bn
Financial year end	December
Most Recent Period (MRP)	Q1:2020

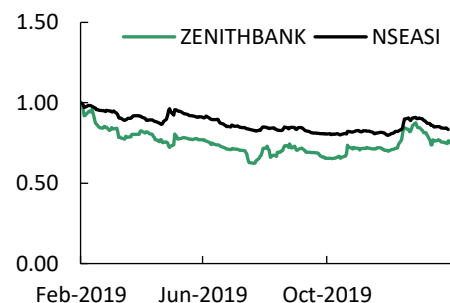


Chart 1: Sensitivity Analysis

Sensitivity Analysis of Dec-2020 Target Price to key model inputs						Min	13.91			
EPS						Max	28.61			
						6.47	6.52	6.57	6.62	6.67
Target PE	2.15x	13.91	14.02	14.13	14.23	14.34				
	2.51x	16.24	16.37	16.49	16.62	16.74				
	2.86x	18.50	18.65	18.79	18.93	19.08				
	3.56x	23.03	23.21	23.39	23.57	23.75				
	4.29x	27.76	27.97	28.19	28.40	28.61				

Financial Highlights (NGN billion) ZENITH BANK PLC Q1:2020 Result

<i>Profit & Loss Account</i>	Q1:2020	Q1:2019	y/y Growth
Gross Earnings	166.81	158.11	5.50%
Interest Income	114.33	122.48	-6.65%
Interest Expense	32.83	36.34	-9.67%
Loan Loss Expense	3.95	2.10	88.50%
Net Interest income after impairment charges	243.00	277.22	-12.34%
Non-Interest Income	52.48	35.63	47.30%
Operating Income	295.48	312.85	-5.55%
OPEX	65.40	59.40	10.10%
PBT	58.79	57.29	2.61%
PAT	50.53	50.23	0.58%
<i>Balance Sheet</i>	Q1:2020	2019FY	
Cash and short-term funds	1,278.46	936.28	36.55%
Loans and Advances to customers	3,589.04	3,012.67	19.13%
Investment Securities	1,721.01	2,014.22	-14.56%
Property and Equipment	186.76	185.22	0.84%
Other Assets	352.64	198.50	77.66%
Total Assets	7,127.92	6,346.88	12.31%
Deposits from customers	4,462.63	4,262.29	4.70%
Financial Liabilities	328.58	361.57	-9.12%
Other Liabilities	1,410.77	781.13	80.61%
Total Liabilities	6,201.98	5,404.99	14.75%
Shareholders' fund	925.94	941.89	-1.69%

Contact Information

Brokerage and Retail Services

topeoludimu@meristemng.com (+234 905 569 0627)
abisoyeoludipe@meristemng.com (+234 708 000 7861)
contact@meristemng.com

Investment Banking/Corporate Finance

seunlijofi@meristemng.com (+234 808 536 5766)

Wealth Management

damilolahassan@meristemng.com (+234 803 613 9123)
www.meristemwealth.com
Tel:+234 01 738 9948

Registrars

muboolasoko@meristemregistrars.com (+234 803 324 7996)
martinaosague@meristemregistrars.com (+234 802 303 1783)
www.meristemregistrars.com
Tel: +23401-280 9250

Group Business Development

saheedbashir@mersitemng.com (+234 802 454 6575)
ifeomaogalue@meristemng.com (+234 802 3942967)

Client Services

omosolapeakinpelu@meristemng.com (+234 803 694 3034)
blessingogwuche@meristemng.com (+234 706 896 5173)

Investment Research

ahmedjinad@meristemng.com (+234 809 183 9487)
research@meristemng.com

Corporate websites: www.meristemng.com www.meristemwealth.com www.meristemregistrars.com

Meristem Research can also be accessed on the following platforms:

Meristem Research portal: meristem.com.ng/rhub

Bloomberg: MERI <GO>

Capital IQ: www.capitaliq.com

ISI Emerging Markets: www.securities.com/ch.html?pc=NG

Reuters: www.thomsonreuters.com

FactSet: www.factset.com

Analyst's Certification and Disclaimer

This research report has been prepared by the research analyst(s), whose name(s) appear(s) on the cover of this report. Each research analyst hereby certifies, with respect to each security or issuer covers in this research that:

- (1) all of the views expressed in this report accurately reflect his or her personal views about any and all of the subject securities or issuers (the Issuer); and
- (2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. Research analysts' compensation is determined based upon activities and services intended to benefit the investor clients of Meristem Securities Limited (the Firm). Like all of the Firm's employees, research analysts receive compensation that is impacted by overall Firm profitability, which includes revenues from other business units within the Firm.
- (3) each research analyst and/or persons connected with any research analyst may have interacted with sales and trading personnel, or similar, for the purpose of gathering, synthesizing and interpreting non-material non-public or material public market information.

As at the date of this report, any ratings, forecasts, estimates, opinions or views herein constitute a judgment, and are not connected to research analysts' compensations. In the case of non-currency of the date of this report, the views and contents may not reflect the research analysts' current thinking. This document has been produced independently of the Issuer. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the ratings, forecasts, estimates, opinions and views contained herein are fair and reasonable, neither the research analysts, the Issuer, nor any of its directors, officers or employees, shall be in any way responsible for the contents hereof, and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith.

Analysts' Compensation: The equity research analysts responsible for the preparation of this report receive compensation based upon various factors, including the quality and accuracy of research, client feedback, competitive factors, and overall firm revenues, which include revenues from, among other business units, Investment Banking.

Investment Ratings

Fair Value Estimate

We estimate stock's fair value by computing a weighted average of projected prices derived from discounted cash flow and relative valuation methodologies. The choice of relative valuation methodology (ies) usually depends on the firm's peculiar business model and what in the opinion of our analyst is considered as a key driver of the stock's value from a firm specific as well as an industry perspective. However, we attach the most weight to discounted cash flow valuation methodology.

Target Price Estimate

While we believe that the fair value is underpinned by the future benefits stream and growth outlooks, which are primary drivers of value, the market might not align to the fair value estimate within the estimated investment horizon. Thus, we do not derive our target price from the fair value but from a trading perspective using the year projected earnings or book value and the respective target multiples. Notwithstanding, we are of the opinion that the variance between the two should not be too significant.

Ratings Specification

- BUY:** Target Price of the stock is above the current market price by at least **10 percent**
- HOLD:** Target Price of the stock ranges between **-10 percent and 10 percent** from the current market price.
- SELL:** Target Price of the stock is more than **10 percent** below the current market price.

Definitions

Price Targets: Price targets reflect in part the analyst's estimates for the company's earnings. The achievement of any price target may be impeded by general market and macroeconomic trends, and by other risks related to the company or market and may not occur if the company's earnings fall short of estimates.

Asset allocation: The recommended weighting for equities, cash and fixed income instrument is based on a number of metrics and does not relate to a particular size change in one variable.

Movements in Price Target

Company Name: Zenith Bank Plc.

Date	Price (N)	Previous Target Price(N)	New Target Price (N)	Previous Recommendation	New Recommendation
21-Feb-2020	19.05	24.43	23.06	BUY	BUY
06-May-2020	14.30	23.06	18.79	BUY	BUY

Company disclosures

Meristem or the analyst(s) responsible for the coverage may have financial or beneficial interest in securities or related investments discussed in this report, which could, unintentionally, affect the objectivity of this report. Material interests, which Meristem or the analyst(s) have with companies or in securities discussed in this report, are disclosed below:

Company	Disclosure
Zenith Bank Plc	

- a. The analyst(s) hold(s) personal positions (directly or indirectly) in a class of the common equity securities of the company.
- b. The analyst responsible for this report, as indicated on the front page, is a board member, officer or director of the company
- c. Meristem beneficially owns 1% or more of the equity securities of the company
- d. Meristem has been the lead manager or co-lead manager of any publicly disclosed offer of securities of the company over the past 12 months.
- e. Meristem beneficially holds a major interest in the debt of the company
- f. Meristem has received compensation for investment banking activities from the company within the last 12 months
- g. Meristem intends to seek, or anticipates receipt of compensation for investment banking services from the company in the next 3 months
- h. The content of this research report has been communicated with the company, following which this research has been materially amended before its distribution
- i. The company is a client of the stock broking division of the Meristem group.
- j. The company is a client of the investment banking division of the Meristem group.
- k. Meristem is the registrar to the company.
- l. The company owns more than 5% of the issued share capital of Meristem
- m. Meristem has other financial or other material interest in the company.

Conflict of Interest

It is the policy of Meristem Securities Limited and its subsidiaries and affiliates (Individually and collectively referred to as “Meristem”) that research analysts may not be involved in activities that suggest that they are representing the interests of Meristem in a way likely to appear to be inconsistent with providing independent investment research. In addition, research analysts’ reporting lines are structured so as to avoid any conflict of interests.

For example, research analysts are not subject to the supervision or control of anyone in Meristem’s Investment Banking or Sales and trading departments. However, such sales and trading departments may trade, as principal, on the basis of the research analysts’ published research. Therefore, the proprietary interests of those Sales and Trading departments may conflict with your interests.

Important Disclosure

For U.S. persons only: This research report is a product of Meristem Securities, which is the employer of the research analysts who has prepared the research report. The research analysts preparing the research report are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analysts are not subject to supervision by a U.S. broker-dealer, and are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This report is intended for distribution by Mersitem Securities only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a 6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor.

Legal entity disclosures

Meristem Securities Limited is a member of The Nigerian Stock Exchange and is authorized and regulated by the Securities and Exchange Commission to conduct investment banking and financial advisory business in Nigeria. However, the company through its subsidiaries carries out stock broking, wealth management, trustees and registrars businesses which are regulated by the SEC and ICMR.

Copyright 2020 Meristem Securities Limited. All rights reserved. This report or any portion hereof may not be reprinted, sold or redistributed without the written consent of Meristem Securities Limited.