

## Back on Track

### Non-core Earnings Continue to Support Top Line

Zenith Bank Plc (ZENITHBANK)'s interest income rebounded strongly (+11.40% YoY) in Q2:2020, after suffering a 6.65% YoY decline in Q1:2020. This culminated in a 1.10% YoY growth in interest income to NGN216.95bn in the first half of the year, backed by the bank's considerable asset growth over the period. However, we note that the current low yield environment continues to weigh heavily on the bank's performance as the growth in interest income failed to adequately reflect the growth in assets. Moreover, the pressure on fee-based income was compounded by the COVID-19 pandemic during the period as net fee and commission income declined by 39.97% YoY to NGN33.50bn. **We are concerned that gains from trading assets and FX revaluations remained the key drivers of topline performance in spite of the bank's robust earning assets base. We are of the opinion that this may not sustainable as these income lines are highly sensitive to regulatory risks.** This development is not encouraging in view of the heightened instability in the regulatory environment. On a positive note, the bank's increased spending on information technology may translate to increased transaction volumes across digital platforms given its robust customer base. **We therefore maintain a modest outlook for gross earnings in 2020FY, with faster rate of economic recovery and stable regulatory environment as upside risks.**

### Bottom Line Growth Regains Momentum

ZENITHBANK 's H1:2020 bottom line performance was rather mixed as profits before tax inched up 2.19% to NGN114.12bn. While the significant decline in Cost of Funds (CoF) to 2.20% (vs. 3.00% in H1:2019) led to an expansion in Net Interest Margins to 9.00% (from 8.60% in H1:2019), higher impairment charges were a major drawback to profitability, pushing Cost of Risk (CoR) to 1.80% (vs. 1.40% in H1:2019). Although higher than our earlier expectations, the bank's CoR in H1:2020 reflects the impact of the pandemic on risk assets and is consistent with industry trends. **We do not expect a further increase in CoR during the rest of the year as loan recoveries increase with economic recovery.** Thus, we maintain our expectation of lower Cost-to-Income ratio (CIR) in 2020FY, notwithstanding the marginal increase to 54.30% from 53.20% in H1:2019. We are pleased with the moderation in OPEX growth to 7.11% from 10.10% in Q1:2020, despite significantly higher donations to support COVID-19 containment efforts in Q2:2020. The 54.82% YoY decline in taxation significantly boosted after tax profits to NGN103.83bn (+16.81% YoY). **In spite of our modest outlook for revenue, we project a moderately bullish outlook for profits, supported by further decline in CoF and improved overall cost efficiency.**

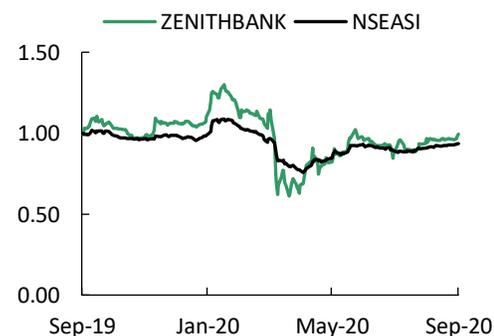
### Mandatory Reserve Debits May Constrain Earnings Growth

The bank has been unrelenting in its quest to grow its assets and retail base, with total assets growth of 19.43% YtD to NGN7.58trn. While we note positively the 11.63% YtD growth in earning assets, the sharp growth (30.56% YtD) in non-earning assets driven by increased mandatory CBN reserves may impair the bank's future earning capacity. Prudential ratios stayed strong within limits in H1:2020 albeit pressured by the pandemic risk assets growth. Capital adequacy ratio fell 200bps to 20.00%, while asset quality deteriorated to 4.70% from 4.30% in 2019FY.

### Recommendation

Based on the bank's short-term earnings outlook, we revise our expected EPS to NGN6.75 from NGN6.57, and target PE to 2.80x from 2.86x, to obtain a revised December 2020 target price of **NGN19.38**. This indicates an upside potential of **18.17%**, hence we recommend a **BUY**.

Company	ZENITHBANK
<b>Valuation</b>	
Trailing EPS	7.13
BVPS	31.50
P/E	2.44x
P/BV	0.55x
Target PE	2.80x
Dec-2020 Exp. EPS	6.92
Dec 2020 Target price	<b>19.38</b>
Current Price	16.40
Up/Downside Potential	+18.17%
<b>Ratings</b>	<b>BUY</b>
<b>Key metrics</b>	
ROE	21.50%
ROA	3.00%
Net margin	30.00%
Asset Turnover	0.09x
Leverage	7.66x
<b>Share/Share Price Statistics</b>	
Yr Hi	22.75
Yr Lo	10.70
YTD return	<b>-11.83%</b>
Beta	1.44
Adjusted Beta	1.30
52-wk average volume	39,514,242
Shares outstanding	31.40bn
Market cap [NGN]	546.30bn
Financial year end	December
Most Recent Period (MRP)	H1:2020



**Chart 1: Sensitivity Analysis**

Sensitivity Analysis of Dec-2020 Target Price to key model inputs						Min	18.41
						Max	20.36
						EPS	
						6.82	6.87
						6.92	6.97
						7.02	
Target PE	2.70	18.41	18.55	18.68	18.82	18.95	
	2.75	18.76	18.89	19.03	19.17	19.31	
	2.80	19.10	19.24	19.38	19.52	19.66	
	2.85	19.44	19.58	19.72	19.86	20.01	
	2.90	19.78	19.92	20.07	20.21	20.36	

**Financial Highlights (NGN billion) ZENITH BANK PLC H1:2020**

<i>Profit &amp; Loss Account</i>	H1:2020	H1:2019	y/y Growth
Gross Earnings	346.09	331.59	4.37%
Interest Income	216.95	214.60	1.10%
Interest Expense	59.55	72.09	-17.40%
Loan Loss Expense	23.92	13.74	74.18%
Net Interest income after impairment charges	133.49	128.78	3.65%
Non-Interest Income	129.13	116.99	10.39%
Operating Income	262.62	245.77	6.86%
OPEX	135.85	126.83	7.11%
PBT	114.12	111.68	2.19%
PAT	103.83	88.88	16.81%
<i>Balance Sheet</i>	H1:2020	2019FY	
Cash and short-term funds	198.96	175.33	13.48%
Loans and Advances to customers	2,624.37	2,305.57	13.83%
Investment Securities (including pledged assets)	1,016.69	959.15	6.00%
Property and Equipment	186.83	185.22	0.87%
Other Assets	3,553.27	2,721.63	30.56%
<b>Total Assets</b>	<b>7,580.11</b>	<b>6,346.88</b>	<b>19.43%</b>
Deposits from customers	4,905.00	4,262.29	15.08%
Financial Liabilities	844.02	754.44	11.87%
Other Liabilities	842.12	388.26	116.89%
Total Liabilities	6,591.14	5,404.99	21.95%
Shareholders' fund	988.98	941.89	5.00%

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## Movements in Price Target

**Company Name:** Zenith Bank Plc.

Date	Price (NGN)	Previous Target Price (NGN)	New Target Price (NGN)	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
10-Sept-2020	16.40	18.79	19.38	BUY	BUY

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Zenith Bank Plc	

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