

Impairment Charge on Ghana's Sovereign Bonds Drags Profitability

Gross Earnings Hit First Double-Digit Growth in Five Years

For the first time since 2017, Zenith Bank Plc. (ZENITHBANK) recorded double-digit growth in gross earnings. Remarkably, the bank's topline improved by 23.51% YoY to NGN945.55bn – driven by funded (+26.33% YoY) and non-funded (+23.28% YoY) income growth. For interest income, the consecutive rate hike in 2022 that spurred the repricing of interest-earning assets was the primary catalyst, as it prompted higher asset yield (8.10% in 2022FY vs 8.09% in 2021FY). Equally, the bank grew its loan book volume and investment securities to lend support. Likewise, higher fees and commission income (supported by a rise in fees on electronic products) and a 26.98% increase in trading gains supported the rise in non-interest income. **Our expectation for 2023FY is that higher asset yield would complement an increase in loan book and investment securities to push interest income up. Also, we envisage that higher e-banking transaction volume stemming from the increased adoption of digital banking combined with the transition of ZENITHBANK to a holding company (creating an opportunity for the integration of other non-banking financial service subsidiaries) will support non-funded income. Therefore, we project a 12.54% YoY increase in gross earnings to NGN1.06trn in 2023FY.**

First Profit After Tax Decline in Nine Years

Owing to the high-interest rate environment and the rapid growth in customers' deposits (+38.68% YoY), the group's cost of funds jumped to 1.90% in 2022FY (vs 1.50% in 2021FY). Nonetheless, the higher asset yield recorded ensured that the net interest margin increased by 60bps to 7.30%. Despite the strong topline growth, the 17.32% YoY increase in operating expenses (fueled by the multi-decade high inflation rate, higher IT expenses, and statutory levies) forced the group's cost-to-income ratio to rise to 54.41% during the period (vs 50.80% in 2021FY). Another significant pressure on the group's earnings was its highest-ever impairment charge (NGN123.25bn) recorded in 2022FY. Primarily, the substantial jump in impairment charges (+105.65% YoY) was due to the industry-wide exposure to Ghana's sovereign bonds. For ZENITHBANK, a total of the value of NGN123.60bn of its existing Government of Ghana bonds were restructured under the Ghana Domestic Debt Exchange Programme. The effect of this, together with the increase in the effective tax rate to 21.34% (from 12.77% in 2021FY), caused the group's Profit After Tax to decline by 8.44% YoY to NGN223.91bn. **In 2023FY, we expect a normalization and decline in impairment charges as the impact of Ghana's exposure wanes. Similarly, we expect the impressive topline improvement to mute the impact of increasing operating expenses and income taxes. Therefore, we project a PAT of NGN252.20bn, translating to 12.63% YoY growth.**

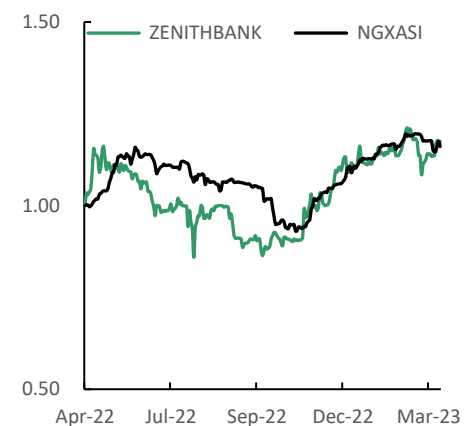
Lower But Sufficient Prudential Ratios

During the period, the group grew its gross loan book by 17.76% to NGN4.12trn. However, due to the deteriorating macroeconomic conditions, the Non-Performing Loans (NPL) ratio rose marginally to 4.30% (vs 4.20% in 2021FY). Nonetheless, sufficient provisions were made, demonstrated by its higher NPL coverage ratio of 115.90% in 2022FY (vs 114.40% in 2021FY). Furthermore, the group's Capital Adequacy Ratio (CAR) and Liquidity Ratio came in above prudential levels at 19.80% and 75.00%, respectively.

Recommendation

Following our PAT forecast, we revised our expected 2023FY EPS upward to NGN8.03. Combining this with a Target PE of 3.53x, we arrived at a target price of **NGN28.36**. Compared to the closing price on 3rd April 2023, our target price shows that the stock has an upside potential of **+9.91%**. Thus, we rate the ticker a **HOLD**.

Company	ZENITHBANK
Valuation	
Trailing EPS	7.14
BVPS	43.92
P/E	3.62
P/BV	0.59
Target PE	3.53x
Dec-2023 Exp. EPS	NGN8.03
Dec 2023 Target price	NGN28.36
Current Price	NGN25.80
Up/Downside Potential	+9.91%
Ratings	HOLD
Key metrics	
ROE	16.84%
ROA	2.06%
Net margin	7.30%
Asset Turnover	0.09x
Leverage	8.91x
Yr Hi	NGN26.65
Yr Lo	NGN23.85
YTD return	+7.50%
Beta	0.48
Adjusted Beta	0.65
Proposed DPS	NGN2.90
Shares outstanding	31.40bn
Market cap [NGN]	810.03bn
Free Float	88.11%
Financial year end	December
Most Recent Period	2022FY



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Chart 1: Sensitivity Analysis

Sensitivity Analysis of Dec-2023 Target Price to key model inputs						Min	27.21
EPS						Max	29.52
		7.93	7.98	8.03	8.08	8.13	
Target PE	3.43x	27.21	27.38	27.55	27.72	27.90	
	3.48x	27.61	27.78	27.95	28.13	28.30	
	3.53x	28.00	28.18	28.36	28.53	28.71	
	3.58x	28.40	28.58	28.76	28.94	29.12	
	3.63x	28.80	28.98	29.16	29.34	29.52	

Financial Highlights and Forecasts (NGN billion)

<i>Profit & Loss Account</i>	2021FY	2022FY	2023F	2024F	2025F	2026F	2027F
Gross Earnings	765.56	945.55	1,064.12	1,083.37	1,118.85	1,184.49	1,243.01
Interest Income	427.60	540.17	628.94	653.13	667.36	711.77	748.02
Interest Expense	106.79	173.54	230.30	237.63	249.82	255.70	245.95
Net Impairment Charges	59.93	123.25	87.88	88.34	87.82	84.34	80.83
Net Interest income after impairment charges	260.87	243.38	310.76	327.16	329.72	371.72	421.24
Non-Interest Income	337.96	405.39	435.18	430.25	451.49	472.72	495.00
Operating Income	598.83	648.76	745.95	757.41	781.21	844.44	916.24
OPEX	289.53	339.69	396.69	389.08	392.66	414.88	434.60
PBT	280.37	284.65	323.13	340.89	359.75	399.31	449.87
PAT	244.56	223.91	252.20	266.06	280.78	319.45	359.90

<i>Balance Sheet</i>	2021FY	2022FY	2023F	2024F	2025F	2026F	2027F
Cash and Balances with Central Banks	1,488.36	2,201.74	2,346.21	3,166.64	4,135.56	4,689.31	5,399.77
Loans and Advances to Banks and customers	3,355.73	4,013.71	4,382.99	4,184.43	4,493.32	4,758.89	5,045.36
Investment Securities	1,303.73	1,728.33	1,963.72	2,020.47	1,863.65	1,935.37	2,009.93
Property and Equipment	200.01	230.84	250.41	276.53	277.01	254.61	230.58
Other Assets	168.21	213.52	204.09	221.43	187.28	203.90	237.06
Total Assets	9,447.84	12,285.63	13,301.74	14,272.14	15,366.53	16,484.79	17,701.63
Deposits from Banks and Customers	6,472.05	8,975.65	9,782.92	10,502.23	11,258.09	12,180.54	13,097.08
Financial Liabilities	487.43	568.56	579.93	591.53	603.36	615.43	627.74
Other Liabilities	8,168.18	10,906.69	11,805.57	12,657.34	13,624.14	14,605.07	15,668.22
Total Liabilities	1,279.66	1,378.94	1,496.17	1,614.80	1,742.39	1,879.72	2,033.41
Shareholders' fund	1,488.36	2,201.74	2,346.21	3,166.64	4,135.56	4,689.31	5,399.77

<i>Financial Ratios</i>	2021FY	2022FY	2023F	2024F	2025F	2026F	2027F
Asset Yield	8.09%	8.10%	8.18%	8.36%	9.25%	9.35%	9.30%
Cost of Funds	1.40%	1.94%	2.20%	2.15%	2.00%	1.90%	1.70%
Net Interest Margin	6.20%	5.28%	4.61%	5.07%	5.31%	5.92%	6.02%
Cost to Income Ratio	48.35%	52.36%	52.05%	50.63%	49.49%	48.49%	46.92%
Net Margin	31.95%	23.68%	24.40%	24.66%	26.44%	28.34%	30.23%
Return on Asset	2.73%	2.06%	2.07%	1.99%	2.16%	2.27%	2.37%
Return on Equity	20.40%	16.84%	18.43%	17.65%	19.03%	19.88%	20.52%
Earnings Per Share	7.79	7.13	8.44	8.76	10.20	11.53	12.92
Asset Turnover	0.09x	0.09x	0.08x	0.08x	0.08x	0.08x	0.08x
Financial Leverage	7.38x	8.91x	8.89x	8.82x	8.80x	8.71x	8.61x

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Movements in Price Target

Company Name: Zenith Bank Plc.

Date	Price (N)	Previous Target Price(N)	New Target Price (N)	Previous Recommendation	New Recommendation
03-Apr-2023	25.80	-	28.36	-	HOLD

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