Nigeria | Equity Research | Banks | Company Update

September 20, 2021

ZENITH BANK PLC

Consolidating on Retail

BLOOMBERG: ZENITHBA NL

BUY

Target Price: N29.83

Ref Price: N23.80

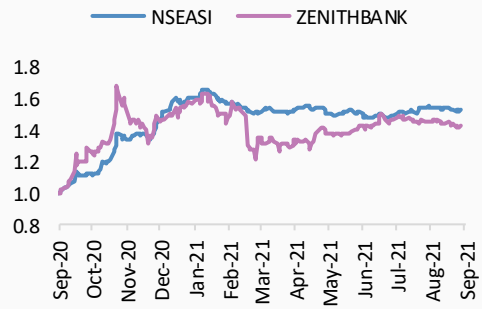
Following the release of ZENITHBANK's H1'21 audited result and the subsequent conference call, we engaged further with the bank's management to ascertain its strategic direction. This report highlights our view on the bank's retail strategy, key performance drivers, and long-term value proposition. Overall, we reaffirm our positive outlook for the counter with a 12-month target price of N29.83 and a BUY rating

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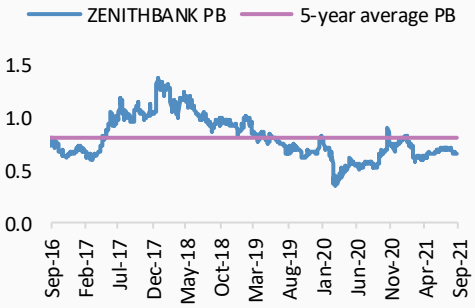
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Market Data	ZENTHBANK
Market Cap (N'bn)	747,236.6
Last close price (N)	23.80
52-week high-low price (N)	28.50/16.60
Avg 3M daily volume (N'mn)	11.31

1-year price performance (rebased)



ZENITHBANK is trailing its historical average PB



Source: NSE; CardinalStone Research

Bank is making the most of its retail foray

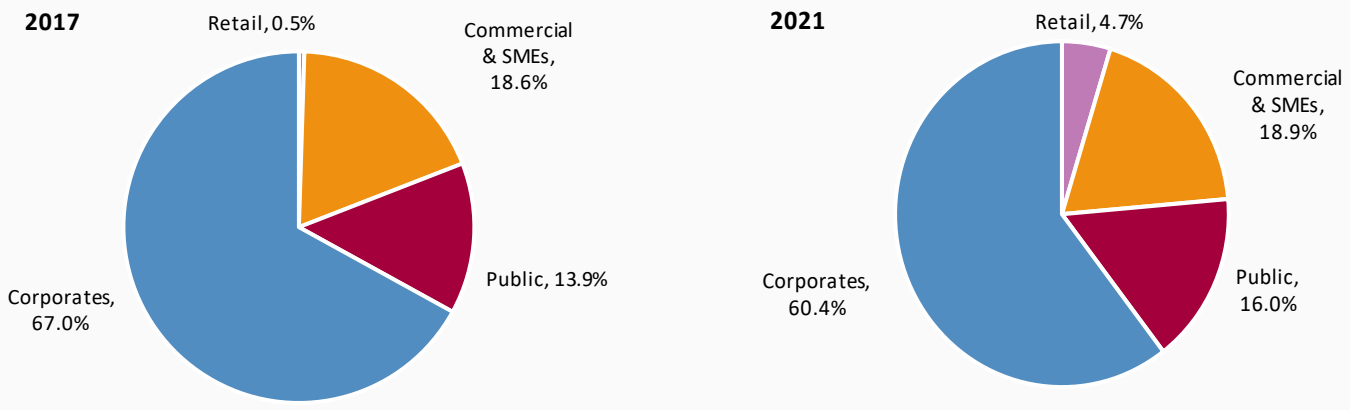
Over the last few years, ZENITHBANK has deepened its penetration in the retail space. This move appears in line with the bank's ongoing strategy, which mainly emphasizes consolidating its retail play. Ultimately, the lender hopes to achieve success in the retail segment akin to that of its corporate arm. Positively, we note some quick wins that have emerged as a result of this retail diversification play:

1. ZENITHBANK may have been late to the retail party, but its recent strides and ongoing initiatives suggest that it is firming its grip on the Nigerian retail banking terrain. To accelerate its retail proposition, the bank recently launched its chatbot, the Zenith Intelligent Virtual Assistant (ZiVA), alongside other digital initiatives[1]. Furthermore, the bank has rapidly grown its agency network from 15,000 in H1'20 to over 62,000 in H1'21. According to management, the accelerated agency growth, combined with the introduction of the Virtual Debit Card, drove the over 3 million increase in the number of cards issued between June 2020 and June 2021. The bank has also set up a digital factory, signaling its shift from a strategy of technological assimilation to one of innovation

2. Retail loans have improved, accounting for 5.0% of gross loans on average over the last three years, compared to an average 1.0% contribution from FY'17 to FY'18. Impressively, the retail loan book has expanded by a 4-year CAGR of 88.0%, compared to a moderate 7.9% for the Public, Corporate, and Commercial & SME segments

[1]The bank has also introduced WhatsApp Banking, Pay with Transfer on POS/Web, NIBSS Quick Response (NQR) platform, Biometric ATM operations, USSD on POS and the Virtual Debit Card

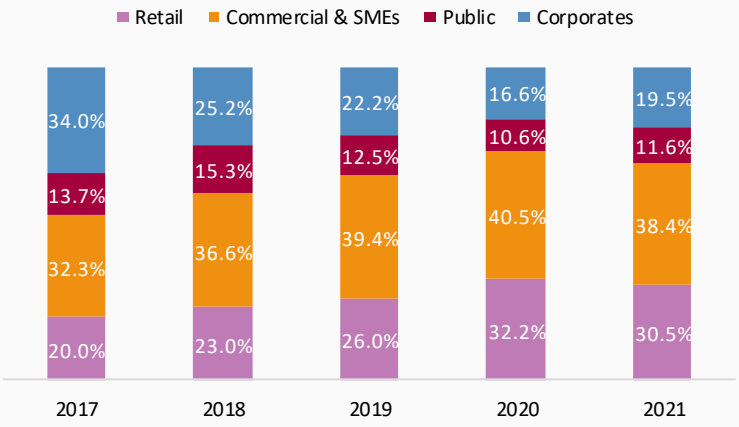
Figure 1: Retail loan contribution have improved from 0.5% in FY'17 to 4.7% in H1'21



Source: Company Filings; CardinalStone Research

3. The retail segment accounted for 46.0% of total deposit growth between FY'17 and H1'21, growing at a CAGR of 26.5%, compared to 9.0% for the other segments. Consequently, Retail is now the second largest contributor to deposits after Commercial & SMEs

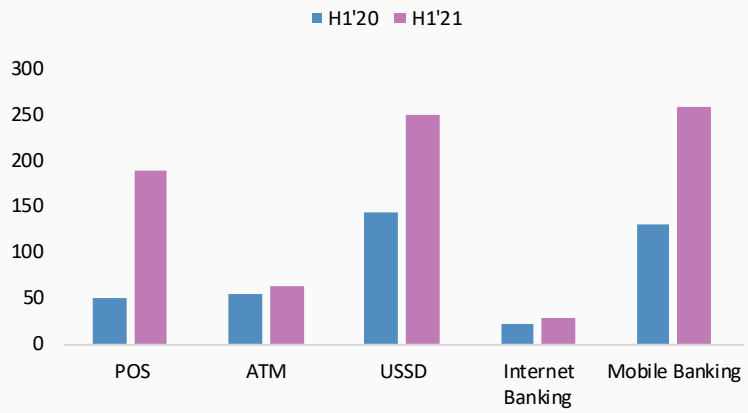
Figure 2: Retail composition of total deposits has expanded over the years



Source: Company Filings; CardinalStone Research

4. The remarkable growth in the bank's electronic transactions volume also appears to be partly driven by its retail strategy

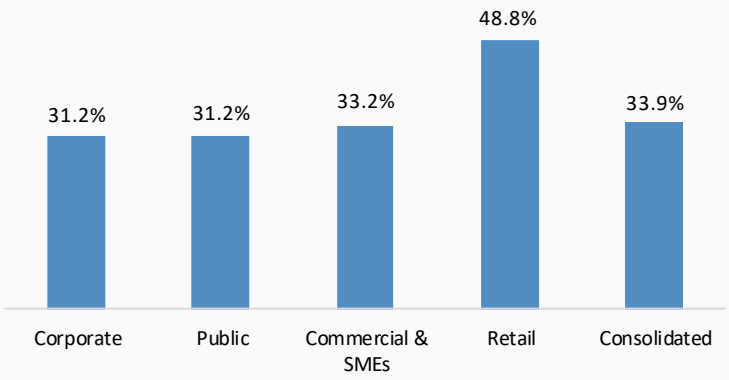
Figure 3: Transaction volumes on digital channels grew 118.0% from H1'20 (in millions)



Source: Company Filings; CardinalStone Research

5. On the whole, the retail expansion drive has largely benefitted earnings. Precisely, retail PBT margin of 48.8% is 16.8 ppts higher than the average of the other business segments. We attribute the segment's broad support to Group PBT margin to the sustained reduction in funding cost (linked to the increase in cheaper retail deposits) and growth in e-business income

Figure 4: Retail PBT margin is the highest across the Group



Source: Company Filings; CardinalStone Research

Looking Beyond Retail

Although we like the bank's retail traction, gross earnings sustainability over the mid-to-long term is likely to require more, given the dynamism of the operating environment. Our comfort level for earnings diversification entails equal contributions from interest income and non-interest revenue (NIR) to gross earnings. Per our assessment, ZENITHBANK's NIR contribution to gross earnings has averaged c.35.0%[2] over the last four years. Although GTCO also has a

[2]Notably, ZENITHBANK's NIR to gross earnings has grown from 24.0% in FY'16 to 40.0% in FY'20

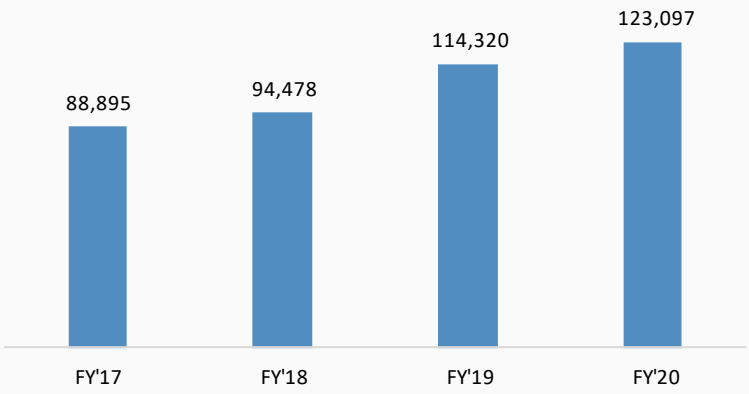
comparable NIR contribution, it plans to increase it to c.50.0% over the next two years, aided by its transition to a HOLDCO. Positively, ZENITHBANK agrees that it will need more than just a retail strategy to support sustainable long-term ROE. It has also hinted that it is constantly scanning the operating environment for threats to its current business value proposition and growth opportunities.

Elsewhere, we note that the following would be vital to the bank's performance in the near to medium term:

1. ZENITHBANK expects to retain its dominance in the corporate banking segment – its key strength area – despite the current retail tilt. Management's goal is to consolidate on its retail successes while simultaneously strengthening the corporate arm

2. Trading revenue is expected to remain relevant for the foreseeable future. Since FY'17, trading revenue has been a mainstay for earnings (c.42.0% of NIR on average), and management is optimistic that the line item will remain resilient in the near term. Specifically, contrary to volatility worries, the bank's T-bills trading income has maintained steady growth and a low standard deviation (S.D of 6.6% vs an average of 14.3% for net interest and net fee incomes) over the last for years.

Figure 5: Treasury bill trading income (in N'billions) has grown by a CAGR of 8.5% over the last 4 years



Source: Company Filings; CardinalStone Research

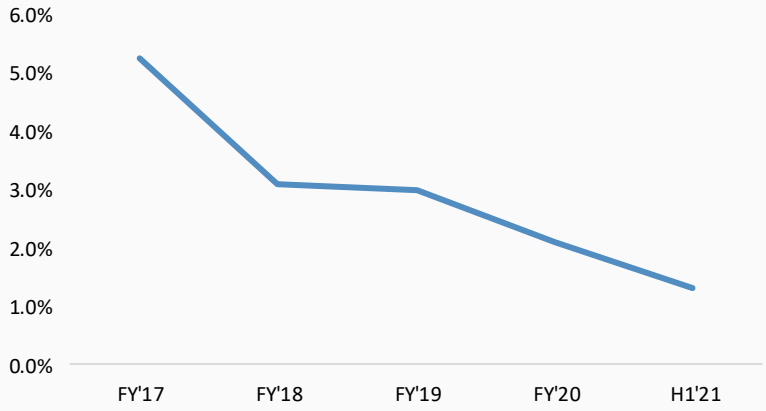
3. Management is also assessing other earnings diversification opportunities, including new products development and geographical expansion.

Long term value proposition

1. We like ZENITHBANK's strong earnings-generating capability, supported an N8.5 trillion asset base of which c.77.0% is interest-earning. This robust interest-earning asset base is likely to continue to support interest income over the long term. Our interest income expectation is also likely to be complemented by the bank's treasury play. As noted earlier, trading income has been a vital contributor to earnings (c.16.0% of gross earnings) and has been less volatile than initially feared. Furthermore, the lender's recent foray into the retail space and the accompanying successes support our positive medium-to-long-term view on the bank's earnings

2. At over N8.0 trillion, ZENITHBANK's funding base appears robust enough to drive long-term asset growth. Management is also optimistic that it could always garner the level of funding needed to push its strategic goals. Notably, the bank has focused on accumulating relatively low-cost funding, as demonstrated by its 93.0% low-cost composition of deposits as at H1'21. This has translated to lower funding cost of 1.3%, which management is confident can fall further

Figure 6: Cost of funds have fallen steeply over the years



Source: Company Filings; CardinalStone Research

3. The bank has recorded successes in its FX liquidity management as reflected in the strong growth in domiciliary deposits[3] and its ability to do swaps. Management has also explained that it is not considering an immediate Eurobond issuance after the current one matures next year. This position is underpinned by the bank's cautious stance regarding funding long-term USD assets. Instead, it believes swaps and domiciliary deposits can cover its short-term liquidity needs As at H1'21, ZENITHBANK had $1.7 billion in swaps, $3.9 billion in domiciliary deposits

[3]This partly enabled the bank to pay down $392.5 million of its Eurobond in 2019, ahead of maturity in 2022

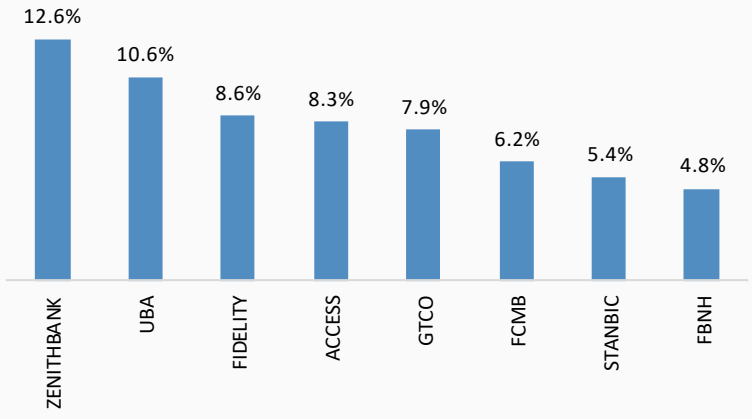
and a net long position of $1.1 billion. The bank's LCY liquidity also appears robust as demonstrated by a liquidity ratio of 70.0%[4]

4. With a capital adequacy ratio (CAR) of 19.0%, ZENITHBANK looks adequately positioned to withstand macroeconomic shocks. The CAR position is more comforting given that its buffer of 400 bps above the regulatory minimum is double our internal comfort threshold of 200 bps. We also note that the CBN's transitional arrangement granted to banks to cushion the impact of IFRS 9 implementation on the regulatory capital likely ended in FY'20. Accordingly, banks may no longer be able to add back IFRS 9 impact adjustments to their Tier 1 capital when computing CAR. Despite this, we believe that ZENITHBANK remains adequately capitalised to support its various long term growth options

5. ZENITHBANK's return on average equity tracks ahead of Tier 1 bank peer average. However, we expect ROE to moderate in FY'21 on projected increase of shareholders' equity. Of our coverage, only ZENITHBANK boasts shareholders' equity of over N1 trillion, and we forecast this equity value to reach N1.2 trillion by FY'21. The substantial equity book value is reflective of the bank's internal earnings-generation and retention capacity, with retained earnings accounting for nearly 46.0%

6. Despite its strong earnings retention, ZENITHBANK has consistently returned value to shareholders, with a 5-year average dividend payout of 45.3%. While we note a consistent payout ratio decline from 49.0% in FY'16 to 41.0% in FY'20, ZENITHBANK has boasted the best dividend yield across our coverage. Specifically, the bank's average dividend yield of 12.6% is at a 4.6 ppts premium over coverage banks' mean of 8.0% (as at qualification date) over the last four years

Figure 7: ZENITHBANK has the highest dividend yield on average over the last 4 years

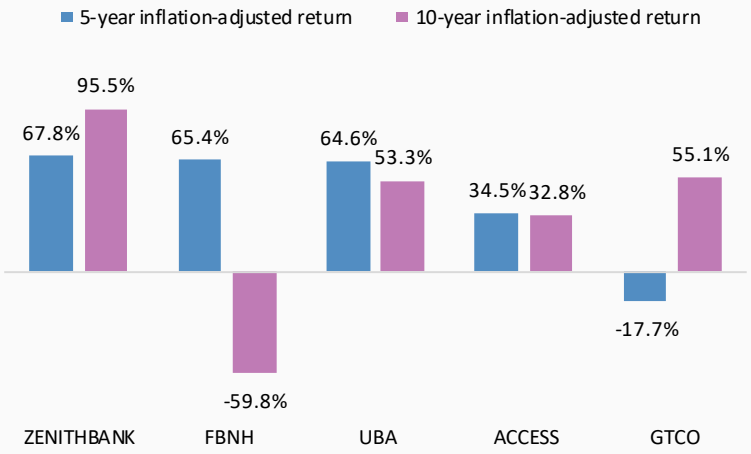


Source: Company Filings; CardinalStone Research

[4]The bank has N1.3 trillion in CRR with the CBN and N460 billion in Special Bills

7. Investment in ZENITHBANK appears to have been a proven hedge against domestic inflation. On an inflation-adjusted basis, the counter has returned 67.8% and 95.5% in the form of total return to shareholders over the last 5 years and 10 years, respectively. These returns are the highest across the tier 1 banking space.

Figure 5: ZENITHBANK has offered the highest inflation-adjusted total return (with dividends reinvested) among Tier 1 banks over the last 5 and 10 years, respectively



Source: Bloomberg; Company Filings; CardinalStone Research

Valuation

After considering management's guidance and strategic initiatives, we reaffirm our positive outlook for ZENITHBANK with an unchanged 12-month target price of N29.83. Our TP portends a potential 25.3% upside compared to our reference price of N23.80. Hence, we retain our BUY rating on the counter. ZENITHBANK is trading at a forward PB of 0.59x, lower than its 4-year average of 0.83x. Our TP of N29.83 also implies a target PB of 0.74x.

Income Statement	2019A	2020A	2021E	2022F	2019A	2020A	2021E	2022F
		(N'Mn)				(US$'Mn)		
Gross Earnings	647,683	672,558	653,805	689,755	1,580	1,640	1,595	1,682
Interest Income	415,563	420,813	408,628	431,335	1,014	1,026	997	1,052
Interest expense	(148,532)	(121,131)	(88,803)	(94,083)	(362)	(295)	(217)	(229)
Net interest income	267,031	299,682	319,825	337,252	651	731	780	823
Non-interest income	232,120	251,745	245,177	258,420	566	614	598	630
Loan loss provisions	(24,032)	(39,534)	(37,835)	(34,682)	(59)	(96)	(92)	(85)
Operating expenses	(231,825)	(256,032)	(259,901)	(275,746)	(565)	(624)	(634)	(673)
Pre-tax earnings	243,294	255,861	267,266	285,244	593	624	652	696
Taxation	(34,451)	(25,296)	(26,424)	(28,201)	(84)	(62)	(64)	(69)
Profit after tax	208,843	230,565	240,843	257,043	509	562	587	627
Statement of Financial Position	**2019A**	**2020A**	**2021E**	**2022F**	**2019A**	**2020A**	**2021E**	**2022F**
Assets								
Cash and short-term funds	936,278	1,591,768	1,387,488	1,470,483	2,284	3,882	3,384	3,587
Interbank placements	707,103	810,494	1,020,745	1,083,248	1,725	1,977	2,490	2,642
Treasury bills and Govt. bonds	2,106,940	2,917,817	3,124,658	3,259,162	5,139	7,117	7,621	7,949
Loans and Advances	2,305,565	2,779,027	2,976,737	3,287,947	5,623	6,778	7,260	8,019
Other Assets	105,777	191,996	157,508	167,573	258	468	384	409
Property and Equipment	185,216	190,170	238,200	260,295	452	464	581	635
Total Assets	6,346,879	8,481,272	8,905,336	9,528,709	15,480	20,686	21,720	23,241
Liabilities								
Customer deposits	4,262,289	5,339,911	5,855,153	6,207,874	10,396	13,024	14,281	15,141
Due to other banks	392,871	384,573	563,519	594,206	958	938	1,374	1,449
Other Liabilities	378,526	714,368	605,563	647,952	923	1,742	1,477	1,580
Taxation & Deferred tax	9,736	11,690	13,779	14,740	24	29	34	36
Borrowings	361,571	913,257	605,563	647,952	882	2,227	1,477	1,580
Total Liabilities	5,404,993	7,363,799	7,643,577	8,112,724	13,183	17,960	18,643	19,787
Capital and Reserves								
Common equity	941,132	1,116,499	1,261,005	1,415,231	2,295	2,723	3,076	3,452
Minority interest	754	974	754	754	2	2	2	2
Shareholders' funds	941,886	1,117,473	1,261,759	1,415,985	2,297	2,726	3,077	3,454
Total liabilities and equity	6,346,879	8,481,272	8,905,336	9,528,709	15,480	20,686	21,720	23,241
Key Ratios	**2019A**	**2020A**	**2021E**	**2022F**	**2019A**	**2020A**	**2021E**	**2022F**
Profitability								
Cost of Funds	3.00%	2.08%	1.30%	1.30%	3.00%	2.08%	1.30%	1.30%
Cost of Risk	1.20%	1.26%	1.20%	1.00%	1.20%	1.26%	1.20%	1.00%
Non-Performing Loan ratio	6.82%	6.41%	6.64%	6.53%	6.82%	6.41%	6.64%	6.53%
Return on Average Equity	23.78%	22.39%	20.24%	19.20%	23.78%	22.39%	20.24%	19.20%
Return on Average Assets	3.40%	3.11%	2.77%	2.79%	3.40%	3.11%	2.77%	2.79%
Valuation Multiples								
P/E (x)	3.6	3.2	3.1	2.9	3.6	3.2	3.1	2.9
P/B (x)	0.8	0.7	0.6	0.5	0.8	0.7	0.6	0.5

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Buy ≥ +15.00% expected share price performance

Hold +0.00% to +14.99% expected share price performance

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% with investment banking relationships	0%	0%	0%	0%

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Company	Disclosure
Zenith Bank Plc	

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