

Zenith Bank Plc: Q3 September, 2010



November 10, 2010

SELL

Fair Value: ₦15.35

Current Price: ₦ 15.40

Valuation/Analyst Recommendation

The Q3 performance of Zenith is in line with our forecast; hence we maintain our earlier forecast but we adjusted the valuation parameters in line with market dictates. We used the Discounted Free Cash Flow Method (DCF), Price-to-Book Multiple (PBM) and Price-to-Earnings Multiple (PEM) to arrive at a fair value. We project Gross Earnings (GE), Profit After Tax (PAT) and Free Cash Flow – FCF (Earnings adjusted for movement in non-cash items) for the periods ending December 2010, 2011, 2012, 2013 and 2014. We estimate the GE of **₦198.03bn, ₦274.11bn, ₦358.03bn, ₦346.87bn** and **₦453.13bn** for 2010, 2011, 2012, 2013 and 2014 respectively. We estimate PAT of **₦40.27bn, ₦55.06bn, ₦72.27bn, ₦70.60bn** and **₦92.71bn** and FCF of **₦50.20bn, ₦68.81bn, ₦90.24bn, ₦88bn** and **₦115.43bn**. We assumed a perpetual growth rate of 7.69%. We used a total of 31.39bn shares. Applying a beta value of 1.58, market risk premium of **10.04%** and risk free rate of **9.90%**, we arrive at a cost of equity of **25.72%** (our discount rate). Using the above parameters, the Discounted Free Cash Flow (DCF) generates **₦13.67** per share. Using an average comparable forward P/E multiple of **12.5x** to capitalize the 2010 EPS of **₦1.28**, we arrive at **₦16.03**. Also using an average comparable PB multiple of **1.52x** to capitalize the Net Asset Value per share of **₦10.76**, we arrive at **₦16.37**. Applying an equal weight of **33.33%** to each of the results of the valuation methods, we arrive at a fair value of **₦15.35** per share. We estimate DPS of **₦0.72** for the period ending December 2010, based on dividend payout of **56.41%**. Buying the stock at the current market price of **₦15.40**, holding it to our fair value of **₦15.35** and adding the present value of the 5-year forecast dividends, investors will earn a total return of **19.17%**. Relating this return to the cost of equity, estimated by CAPM at **25.72%**, investment in Zenith shares will earn a negative return (alpha return) of **6.55%**. The 2010 forward earnings yield **8.35%**, while the 2010 forward Dividend Yield based on **₦0.72** Dividend Per Share at our fair value generates **4.68%**. We therefore place a **SELL** on the Shares of Zenith at the current market price.

Business Description

Zenith Bank's principal activities involve provision of comprehensive banking and other financial services to its customers

Ticker	Zenith
Sector	Banking
Date of Incorporation	May 30, 1990
Date of Listing	October 21, 2004
Year End	December
No of Ordinary Shares	31,396,493,786
Capitalisation(N)	483,506,004,308.25
% of Market Capitalisation	5.96
52-Week High(N)	19.96
52-Week Low(N)	11.21
YTD Return %	42.83
52-Week Avg. Trade	21,084,448
Beta Value	1.58
Current EPS (N)	1.29
Current PE (x)	11.21

Driven By Technology:

The unaudited Q3 2010 result of Zenith Bank Plc (Zenith) for the period ended September 30, 2010 showed that its Gross Earnings (GEs) declined by **13.62%** to **₦139.60bn**, compared with **₦161.61bn** recorded in the corresponding period of 2009. The low inter-bank rates and deposit rates that dominated the market in the first 8 months of the year resulted in a decline in interest expenses for the bank, leading to a marginal improvement of 2.03% in net interest income from **₦61.91bn** in Q3 2009 to **₦63.16bn** in Q3 2010. The drop in operating expenses and diminution in asset value helped to boost Profit Before Tax (PBT), which increased significantly by **196.30%** to **₦39.16bn** in 2010 from **₦13.22bn** in 2009. The tax provision which increased by **286%** between 2009 and 2010 to **₦8.03bn** from **₦2.08bn** brought about a Profit After Tax (PAT) of **₦31.13bn** in 2010 as against **₦11.14bn** in 2009, representing an increase of **179.54%**.

Looking at the bank's profit margins, the costs associated with a unit of GEs decreased between Q3 2010 and Q3 2009 and also decreased over the position as at the end of the financial year in 2009. The PBT margin increased to 28.05% in Q3 2010 from 8.18% as at Q3 2009, and up from 12.65% as at the end of the financial year in December 2009. This showed that the Bank's total costs as a percentage of GEs stood at **71.95%** in Q3 2010, down from **91.82%** in the corresponding period of 2009. PAT margin currently stands at **22.30%**, up from 6.89% in the corresponding period of 2009 and up from 7.43% as at FY 2009. The result also indicated that the percentage of the GEs, PBT, and PAT in the Q3 2010 to the Full Year Audited GEs, PBT and PAT for the period ended September 2010 are: **50.34%, 111.61%** and **151.09%**, respectively. Given the current run rate, the bank should surpass its previous year bottom line performance, but needs to work out ways of growing its top line.

A review of the balance sheet of the bank shows that it continued its deposit generating drive with low cost of fund at 82%, dominating the deposits in Q3 2010. The bank is expanding its loan books to take advantage of financing opportunities in the economy. The analysis of the gross loans of **₦754.08bn** as at September 2010 shows that Oil & Gas (Upstream & downstream) accounted for 16.78% followed by Cement & Other Manufacturing at 13.10%. The gross loan to deposit ratio stood at 59% in Q3 2010, lower than 59.49% in December 2009 and below the regulatory requirement of 80%, showing additional room to grow risk assets. In addition 72.2% of the interest income was derived from loans and advances in Q3 2010. The non-performing loans stood at **₦48.38bn** as at September 2010, while NPL ratio stood at 6.4% as at September 2010, down from 6.5% as at June 2010.

As part of the ongoing reform in the banking industry, the Central Bank of Nigeria (CBN) has repealed the universal banking model and approved the guidelines for the new banking model. The repeal of the current Universal Banking Model is part of CBN's strategic initiative to enhance the quality of banks, ensure financial system stability and promote the evolution of healthy financial sector. Banks operating in Nigeria are required to apply to the CBN for a new operating license which can either be commercial or merchant banking license. Commercial banks can operate at regional, national and international levels with paid up share capital of **₦10bn, ₦25bn** and **₦50bn** respectively. Under the current model, banks in Nigeria are allowed to carry out a wide range of non-banking services which include insurance, investment advisory, assets management services. The objective of the new model is to ensure that banks focus on their core banking business and develop specialization. Banks operating in Nigeria are required to submit their plans on how they intend to transform to the new system within 90 days from October 4, 2010. Meanwhile, the Board of Asset Management Corporation of Nigeria (AMCON) has approved the purchase of the non-performing loans in excess of **₦2trillion** from the banking industry.

As at December 31, 2009 the holders (direct or indirect) of 5% or more of the issued share capital of the Bank were: **Mr. Jim Ovia** (9.53%) and **Institutional Investors Limited** (6.92%) while the remaining **83.55%** shares were held by Nigerian Citizens and Associations. Zenith's products and services are divided into two main sub-headings, the individual products /services and the corporate products/services. The individual products /services include amongst others: Account Opening, Zenith Mortgage loan, Z-cards, Alertz, Z-Mobile, and ZECA (Zenith Children's Account). The corporate products/services include among others: Corporate Banking, Investment Banking, Private Banking and Retail Banking. The Bank's subsidiaries include: **Zenith General Insurance, Zenith Pensions Custodian, Zenith Securities, Zenith Registrars, Zenith Life Assurance, Zenith Capital, Zenith Trustees, Zenith Bank Ghana, Zenith Bank UK, Zenith Bank Sierra Leone** and **Zenith Medicare**. The Bank also acquired significant shareholding in some companies and has seven associated companies incorporated under the Small and Medium Enterprises.

Industry Analysis (N'mn). As at December 2009.

Company	GEs	PBT	PAT	PAT Margin (%)	ROAE (%)	NPL (%)	EPS*	PE*
Zenith Bank	277,300	35,085	20,497	7.43	6.02	6.47	1.29	11.21
GT Bank	162,550	27,963	23,676	14.57	12.98	11.87	1.46	11.17
First Bank	196,408	11,585	3,189	1.62	0.99	8.23	0.85	15.28
UBA	246,725	6,637	2,113	0.86	1.27	3.69	-	-

Source: Company Annual Reports, NSE FACTBOOK. * Current

Financial Performance (N'mn)

	Q3 2010	Q3 2009	%Δ	FY 2009	FY 2008	%Δ	FY 2010F
Gross Earnings	139,601	161,613	13.62	277,300	211,639	31.00	198,031
PBT	39,159	13,216	196.30	35,085	56,112	(37.50)	52,129
PAT	31,130	11,136	179.54	20,603	51,993	(60.40)	40,268
PBT Margin (%)	28.05	8.18	19.87	12.65	26.51	(13.86)	26.32
PAT Margin (%)	22.30	6.89	15.41	7.43	24.57	(17.14)	20.33

Zenith Bank vs NSE ASI Rebased (Nov., 09 - Nov., 10)

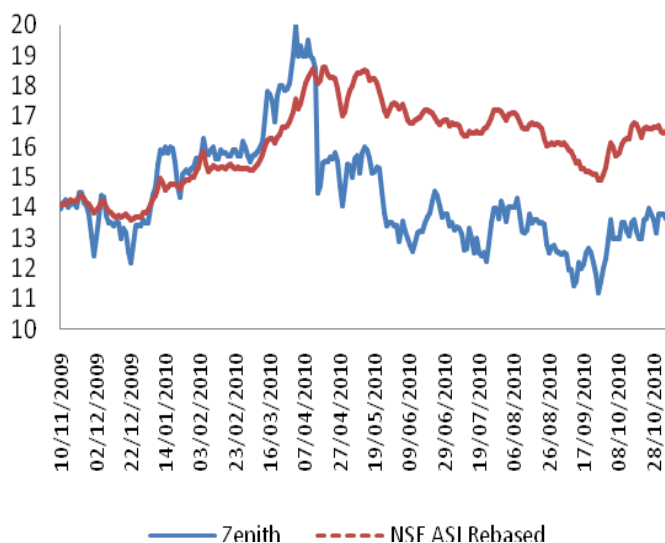


Table 3: Directors Shareholding as at December 31, 2009

Director	Position	No of Shares
Macaulay Pepple	Chairman	2,198,236
Jim Ovia *	MD/CEO	2,392,340,140
Godwin Emeziele **	DMD	35,760,635
E.M. Egwuenu	Director	620,669,139
SP.O Fortune Ebie	Director	3,959,524
L.F.O Obika	Director	3,612,948
Steven Omojafor	Director	2,252,403
Babatunde Adejuwon	Director	3,002,283
Baba Tela	Exe. Director	-
Peter Amangbo	Exe. Director	10,178,571
Elias Igbin Akenzua	Exe. Director	14,231,074
Apollos Ikpoba	Exe. Director	15,182,141
Andy Ojei	Exe. Director	11,269,285
Udom Emmanuel	Exe. Director	11,249,998

* Retired following CBN Directive **Appointed MD/CEO

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