

CREDIT OPINION

20 May 2019

Update

✓ Rate this Research

RATINGS

Zenith Bank Plc

Domicile	Lagos, Nigeria
Long Term CRR	B1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	B2
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	B3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Zenith Bank Plc

Update to credit analysis

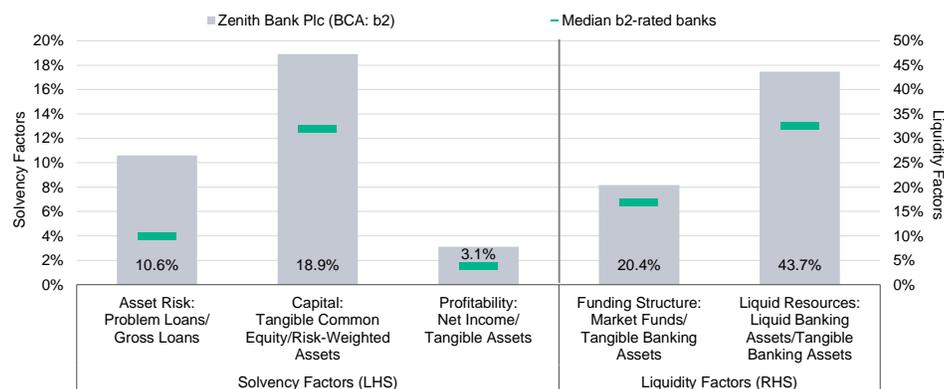
Summary

We assign local currency deposit ratings of B2/Not Prime to [Zenith Bank Plc](#) (Zenith). The long-term local currency deposit rating is underpinned by our baseline credit assessment (BCA) of b2 for Zenith. We also assign foreign currency deposit ratings of B3/Not Prime, local and foreign currency issuer ratings of B2, local currency national scale deposit ratings of Aa3.ng/NG-1, foreign currency national scale deposit ratings of A3.ng/NG-2 and a CR Assessment of B1(cr)/Not Prime (cr) to the bank.

Zenith Bank's BCA of b2 reflects (1) the bank's resilient earnings generating capacity and robust capital buffers, which together provide a cushion to withstand asset quality deterioration; (2) the bank's high liquidity buffers and a predominantly deposit funded balance sheet; and (3) the bank's robust franchise, which allows it to attract inexpensive deposits and to lend to high credit quality borrowers (relative to other Nigerian banks), resulting in relatively strong asset quality metrics and low credit costs. These strengths are balanced against (4) Nigeria's challenging operating environment which will negatively affect the bank's asset quality and revenue growth; and (5) the bank's high proportion of more confidence sensitive corporate deposits versus retail deposits.

Exhibit 1

Rating Scorecard Key Financial Ratios



Source: Moody's Investors Service

Credit strengths

- » Relatively solid asset quality with strong nonperforming loan coverage
- » Strong franchise which supports revenue generation and profitability, in turn supporting capital
- » Predominantly deposit funded and relatively strong liquidity buffers

Credit challenges

- » Nigeria's challenging macroeconomic environment
- » Relatively high dependence on confidence sensitive corporate deposits over retail deposits

Outlook

All deposit ratings assigned to Zenith carry a stable outlook. The stable outlook reflects our expectations that the bank's pre-provision profits can absorb any increase in loan loss provisions and that overall, the bank's credit fundamentals will continue to compare favorably with peers despite continued pressures arising from the challenging operating environment in Nigeria.

Factors that could lead to an upgrade

Given that Zenith's BCA is already at the same level as Nigeria's issuer rating of B2, there is limited scope for an upgrade in the short term. Zenith's ratings could be upgraded if operating conditions improve and Nigeria's sovereign rating is upgraded, while the bank maintains its strong financial metrics.

Factors that could lead to a downgrade

Zenith's ratings could be downgraded if its asset quality deteriorates meaningfully, putting pressure on the bank's profitability and capital buffers. A substantial deterioration of the bank's foreign currency liquidity buffers would also likely trigger a downgrade, as would a downgrade of the sovereign itself.

Key indicators

Exhibit 2

Zenith Bank Plc (Consolidated Financials) [1]

	03-19 ²	12-18 ²	12-17 ²	12-16 ²	12-15 ²	CAGR/Avg. ³
Total Assets (NGN Million)	5,879,172.0	5,955,710.0	5,595,253.0	4,739,825.0	4,006,842.0	12.5 ⁴
Total Assets (USD Million)	16,285.8	16,384.3	15,542.4	15,048.0	20,129.8	(6.3) ⁴
Tangible Common Equity (NGN Million)	752,365.0	787,677.0	789,411.0	687,887.0	586,206.0	8.0 ⁴
Tangible Common Equity (USD Million)	2,084.1	2,166.9	2,192.8	2,183.9	2,945.0	(10.1) ⁴
Problem Loans / Gross Loans (%)	10.6	5.0	4.7	3.0	2.2	5.1 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	--	18.9	20.5	18.1	18.2	18.9 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	22.9	10.2	11.2	9.4	7.0	12.2 ⁵
Net Interest Margin (%)	5.9	5.3	5.2	5.6	5.9	5.6 ⁵
PPI / Average RWA (%)	--	6.2	7.6	5.3	4.7	5.9 ⁶
Net Income / Tangible Assets (%)	3.4	3.3	3.1	2.7	2.6	3.0 ⁵
Cost / Income Ratio (%)	50.0	47.4	42.9	48.0	51.2	47.9 ⁵
Market Funds / Tangible Banking Assets (%)	20.5	20.4	19.6	17.6	16.1	18.8 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	45.5	45.1	43.6	43.1	42.3	43.9 ⁵
Gross Loans / Due to Customers (%)	54.3	54.6	65.5	79.1	79.5	66.6 ⁵

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel II; IFRS. [3]May include rounding differences due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime. [6]Simple average of Basel II periods presented.

Source: Moody's Investors Service; Company Filings

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Profile

Zenith Bank Plc (Zenith) is a full-service commercial bank that offers corporate banking, commercial and consumer banking, personal and private banking, trade services and foreign exchange and treasury and cash management services. It was established in May 1990, and commenced operations in July of the same year as a commercial bank. Zenith became a public limited company on June 17, 2004 and was listed on the Nigerian Stock Exchange (NSE) on October 21, 2004 following a highly successful Initial Public Offering (IPO).

As of December 2018, Zenith reported consolidated total assets of NGN6.0 trillion (about \$16.4 billion).

Detailed credit considerations

Solid asset quality metrics underpinned by a conservative approach to risk

Zenith Bank has managed to keep its reported problem loans ratio under 5.0% (4.9% in Q1 2019 vs. 4.3% in Q1 2018) while reducing the size of its loan portfolio (Naira 1.94 trillion in Q1 2019 from 2.0 trillion in Q1 2018), as the bank tightened its lending standards and deleveraged in 2018. NPLs continue to be highly concentrated in the oil & gas industry (39.9% of total NPLs in Q1 2019), on account of borrowers in the upstream/extractive sector. The bank has a solid NPL coverage ratio of 156% (including regulatory reserves), which compares positively against b2 rated banks. Zenith's NPLs remain below system-wide NPLs (11.7% in December 2018) and we expect continued stability in Zenith's NPLs over the next 12 to 18 months as macroeconomic conditions in Nigeria gradually improve. Moderate growth in Zenith's loan portfolio will also be supportive of a slight improvement in the bank's NPL ratio.

The bank's asset quality metrics compare favorably to its Nigerian peers and are on account of its exposure to debtors with relatively stronger credit profiles, such as large and diversified Nigerian conglomerates. The bank also adopts a prudent approach to risk management which includes conservative underwriting standards and the use of thorough risk management procedures. The bank's conservative stance was demonstrated in the 2009 banking crisis when reported NPLs peaked at just 6.5%, compared to around 37% for the banking system.

However, some aspects of the Zenith's current loan portfolio are credit negative, in our view. The bank's Moody's adjusted NPL ratio is higher than equally rated peers (10.6% in Q1 2019 vs. a median of 4.0% for banks with a b2 baseline credit assessment).

Additionally, we view the bank's exposure to foreign currency denominated loans (40.2% of total loans as of Q1 2019), though in line with the banking system average, as a weakness (see Exhibit 3). The foreign currency denominated portfolio exposes the bank's borrowers to the exchange rate volatility of the Naira, though we note that the bank has restructured many of these loans and, as such, they remain performing. Additionally, Zenith Bank's loan portfolio is concentrated; single name concentration risk is indicated by the bank's top 20 borrowers, which make up over 90% of the bank's tangible capital, exposing capital to significant erosions if one or a few of the top obligors default. It should be noted, however, that Zenith's level of concentration risk is significantly less than that witnessed in other Nigerian banks.

Solid capital buffers reinforced by a robust franchise which supports profitability

Zenith Bank's credit profile is also underpinned by robust capital buffers. As of YE 2018 tangible common equity as a percentage of risk-weighted assets stood at 18.9%. Zenith's ratio is significantly higher than the global b2 BCA peer median of 12.7%. The bank's capital ratio fell by 160bps in 2018, as the extra provisioning requirements from IFRS 9 were deducted from retained earnings instead of the profit & loss statement.

Going forward, we expect the bank's capitalisation to remain strong, primarily because of Zenith's resilient profitability metrics. In the first 3 months of 2019 Zenith had a return on assets of 3.4% (vs. 3.3% in 2018 and 3.1% in 2017), in line with its 3 year average and significantly better than the global b2 BCA peer median of around 1.6%. Profitability is supported by the bank's robust franchise which allows it to attract cheaper deposits and lend to high credit quality borrowers (relative to other Nigerian banks), resulting in relatively low credit costs. The bank's strong franchise has allowed Zenith to keep its funding cost low (3.0% in Q1 2019), further supporting profitability, despite a contraction of the loan portfolio and a fall in Nigerian government yields. The bank has also managed to keep improving its cost-to-income ratio (50.9% in Q1 2019 vs. 53.3% in Q1 2018) due to a reduction in operating costs by 19% over this period. In the medium-term we expect Zenith's profitability to continue to comfortably absorb the cost of risk emanating from its loan portfolio.

Exhibit 3

Zenith holds thicker capital buffers compared to global peers Tangible Common Equity As a Percent of Risk Weighted Assets



Source: Moody's Investors Service

That said, we view Zenith's reported capitalization as being moderated by the bank's exposure to foreign currency loans and to the government of Nigeria. Government securities are risk-weighted at zero under the domestic regulatory framework, as such, in order to more fully capture the risks associated with government bonds, our practice globally is to assign a risk-weight to sovereign debt holdings, as per the Basel Committee. For a sovereign rated B2, we assign a 100% risk-weighting to government securities. Regarding the bank's exposure to foreign currency loans, the bank's capital is vulnerable to a further depreciation of the Naira against foreign currencies, especially the US dollar, as naira depreciation will inflate risk-weighted assets.

However, our scenario analysis shows that the bank's solvency remains robust even under a stressed scenario given the bank's high capital buffers.

Low reliance on market funding and high liquidity buffers moderated by predominantly corporates deposits

Our BCA also reflects the bank's solid liability profile. The bank is predominantly deposit funded with a low reliance on more sensitive market funds (deposits made up about 64.8% of the bank's funding sources in 2018). Additionally, the bank has been committed to reducing its reliance on market funding; in April 2019 it redeemed its USD500mn maturing Eurobond which it does not plan on refinance. However, we note that the majority of deposits are corporate deposits (about 59%) which we consider to be more market sensitive and expensive than retail deposits.

The bank's liquidity profile is stronger than international peers with the liquid banking assets to tangible banking assets ratio at 45.1% as of YE 2018 vs. a median for its b2-BCA peers of 32.6%. The bank also has a robust foreign currency liquidity profile with dollar liquid assets to total dollar deposits at 60.5% as of December 2018. We expect that the bank will use some of its excess foreign currency liquidity to pay off maturing Eurobonds while maintaining adequate liquidity buffers

Support and structural considerations

Government support

Given that Zenith's BCA is at the same level as the Nigerian government's issuer rating of B2, stable, we do not incorporate any rating uplift on the bank's BCA despite Moody's assessment of a 'High' probability of support in case of financial stress, given the strong market position of the bank (3rd largest bank in Nigeria with a market share of 18.4% of total assets and designated a 'Systemically Important Bank').

We assign Foreign Currency Deposit Ratings of B3/Not Prime to Zenith, which are constrained by a foreign currency deposit ceiling, due to the convertibility risks associated with foreign currency deposits.

Counterparty Risk Ratings (CRR)

Counterparty Risk Ratings are opinions of the ability of entities to honour the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

Zenith's CRR Rating is positioned at B1/Not Prime.

Counterparty risk assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

Zenith's CR Assessment is positioned at B1(cr)/Not Prime(cr).

The CR Assessment is positioned one notch above the Adjusted BCA of b2, and therefore above the deposit ratings, reflecting our view that its probability of default is lower than that of deposits. We believe senior obligations represented by the CR Assessment will be more likely preserved in order to limit contagion, minimize losses and avoid disruption of critical functions.

National scale rating

Zenith's national scale ratings of Aa3.ng/NG-1 for local currency deposits and A3.ng/NG-2 for foreign currency deposits are generated from the bank's global scale ratings through maps specific to each country. NSRs are not intended to rank credits across multiple countries; instead they provide a measure of relative creditworthiness within a single country (Nigeria in the case of Zenith). Moody's NSRs are given a two-letter suffix to distinguish them from the agency's Global Scale Ratings. For example, NSRs in Nigeria have the country abbreviation "ng".

Zenith's national scale ratings capture the bank's (1) robust capital buffers, which provide a relatively thick cushion to withstand asset quality deterioration; (2) low stock of reported NPLs; (3) high liquidity buffers, complimenting a predominantly deposit funded balance sheet; and (4) a strong and well-established franchise, which allows the bank to attract inexpensive deposits and to lend to high credit quality borrowers (relative to other Nigerian banks), resulting in relatively low NPLs and credit costs. These strengths are partially moderated by the bank's high proportion of more confidence sensitive corporate deposits versus retail deposits.

Rating methodology and scorecard factors

Exhibit 4

Zenith Bank Plc

Macro Factors

Weighted Macro Profile	Very Weak +	100%
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Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	10.6%	caa2	↔	caa2		
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel II)	18.9%	ba3	↔	ba3		
Profitability						
Net Income / Tangible Assets	3.1%	ba1	↓	ba1		
Combined Solvency Score		b1		b1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	20.4%	b3	↑	b3		
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	45.1%	b1	↓	b2	Expected trend	
Combined Liquidity Score		b2		b3		
Financial Profile						
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				B2		
Scorecard Calculated BCA range				b1 - b3		
Assigned BCA				b2		
Affiliate Support notching				0		
Adjusted BCA				b2		

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Counterparty Risk Rating	1	0	b1	0	B1	B1
Counterparty Risk Assessment	1	0	b1(cr)	0	B1(cr)	
Deposits	0	0	b2	0	B2	B3
Senior unsecured bank debt	0	0	b2	0		B2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
ZENITH BANK PLC	
Outlook	Stable
Counterparty Risk Rating	B1/NP
Bank Deposits -Fgn Curr	B3/NP
Bank Deposits -Dom Curr	B2/NP
Baseline Credit Assessment	b2
Adjusted Baseline Credit Assessment	b2
Counterparty Risk Assessment	B1(cr)/NP(cr)
Issuer Rating	B2
Senior Unsecured	B2
ST Issuer Rating	NP

Source: Moody's Investors Service

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