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Zenith Bank PLC

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Zenith Bank PLC

SACP	b	+	Support	0	+	Additional Factors	0

Anchor	b	
Business Position	Adequate	0
Capital and Earnings	Moderate	0
Risk Position	Adequate	0
Funding	Above Average	0
Liquidity	Adequate	

ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

Issuer Credit Rating
B/Stable/B

Major Rating Factors

Strengths:	Weaknesses:
• Leading franchise in Nigeria. • Good profitability.	• Limited geographic diversification. • High economic and industry risk associated with operating in Nigeria. • High concentration risks

Outlook: Stable

S&P Global Ratings' outlook on Nigeria-based Zenith Bank PLC (Zenith) is stable, reflecting the outlook on the Federal Republic of Nigeria (B/Stable/B). As the Nigerian economy slowly recovers, we believe that the bank's financial and business profiles will remain broadly unchanged.

We would lower our ratings on Zenith, over the next 12 months, if we downgraded Nigeria or if the bank's asset-quality indicators, capitalization, or profitability deteriorated significantly.

A positive rating action is unlikely over our 12-month outlook horizon, because it would hinge on an upgrade of Nigeria as well as material strengthening of Zenith's asset-quality indicators, all other factors being equal.

Rationale

The ratings on Zenith reflect its leading market position in Nigeria, underpinned by a strong corporate franchise and a sizable branch network that enables the bank to maintain a stable and low-cost funding base. Despite a challenging operating environment, we believe that Zenith's profitability, capitalization, and asset-quality indicators will remain broadly stable and continue to compare well with those of domestic peers. In our base-case scenario, we exclude materialization of concentration risk, though. Zenith runs a significant asset-liability mismatch, which we view as a source of liquidity risk. We take comfort from the bank's sizable cash cushion in foreign currencies, covering about 15% of foreign currency deposits as of Dec. 31, 2016.

Anchor: 'b' for banks operating only in Nigeria

We use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Nigeria is 'b', based on an economic risk score of '10' and an industry risk score of '9'.

We think the economic environment in Nigeria has weakened on the back of low oil prices, a restrictive foreign exchange regime, and delayed fiscal stimulus. We now consider that the Nigerian economy and banking sector are in a correction phase. We project slow economic recovery with 1% real GDP growth in 2017 and 3% in 2018. We also anticipate real credit growth (excluding the impact of depreciation and inflation) to moderate, and believe that credit losses will hover around 3%-4% in 2018, compared with 3.5% in 2016.

Regarding industry risk, we consider regulatory oversight as weak. We acknowledge, however, that the Central Bank of Nigeria (CBN) has striven to strengthen stability and align its oversight framework with international best practices.

The mergers and acquisitions that followed the 2009 global financial crisis established a more stable tiering of banks based on size and distribution scale, and cemented the positions of the top-tier banks. However, mounting pressure on banks' earnings from the restrictive foreign currency regime and a higher cost of risk might affect the overall competitive dynamics of the banking system and lead to further consolidation.

In addition, we see rising risk caused by shortages of U.S. dollar funding and slower growth in customer deposits. Although Nigerian banks are largely funded by customer deposits, their external funding has risen in the past two years, which poses an increased risk in the current foreign-exchange regime.

Table 1

Zenith Bank PLC Key Figures

		--Year-ended Dec. 31--			
(Mil. NGN)	**2017***	**2016**	**2015**	**2014**	**2013**
Adjusted assets	4,915,440	4,735,180	4,003,602	3,753,062	3,141,198
Customer loans (gross)	2,299,442	2,360,809	2,032,256	1,758,335	1,276,122
Adjusted common equity	682,324	619,009	524,679	482,978	446,152
Operating revenues	257,145	363,619	307,551	296,052	264,472
Noninterest expenses	121,808	173,086	166,638	162,974	146,245
Core earnings	76,073	131,087	105,544	99,760	92,487

*Data as of June 30. NGN--Nigerian naira.

Business position: Top-tier bank with stable revenues

We view Zenith as one of the leading banks in the competitive Nigerian banking sector. The bank enjoys a strong corporate banking franchise with good revenues stability but remains concentrated in its home country. With total assets of Nigerian naira (NGN)4.9 trillion (approximately $15.7 billion) at midyear 2017, Zenith is the largest bank in

Nigeria, with a market share of about 15% of the system's loans and deposits.

Zenith's strategy remains focused on increasing low-cost retail deposits, to lend competitively to large, low-margin, but creditworthy corporate entities, or invest in government bonds. We believe that Zenith's position in the market will enable it to continue to generate stable revenues over the next 12 months. Zenith's return on average assets (defined as core earnings over average adjusted assets) reached 3% at year-end 2016, and compares well with peers'.

We consider Zenith's geographic diversification to be a relative weakness. Around 10% of the bank's revenues came from international activities in 2016, including 7.7% from Africa and 2.3% from Europe.

Table 2

Zenith Bank PLC Business Position					
		--Year-ended Dec. 31--			
(%)	**2017***	**2016**	**2015**	**2014**	**2013**
Total revenues from business line (mil. NGN)	257,145	363,619	309,166	296,562	280,792
Commercial & retail banking/total revenues from business line	91.0	90.8	93.4	93.8	88.1
Other revenues/total revenues from business line	9.0	9.2	6.6	6.2	6.2
Return on equity	21.2	20.0	18.4	18.8	19.6

*Data as of June 30. NGN--Nigerian naira.

Capital and earnings: Stable capitalization

Our assessment of Zenith's capital and earnings as moderate reflects our opinion that the group will maintain a RAC ratio before adjustments above 5% over the next 12-18 months, after having reported a risk-adjusted capital (RAC) ratio of 5.1% at the end of 2016. On June 30, 2017, the bank was operating with a Basel II regulatory capital adequacy ratio of 21%. We expect the bank to manage capital tightly, balancing moderate earnings growth with slower risk-asset accumulation.

Our projected RAC ratio for Zenith takes into account the following assumptions throughout 2017 and 2018:

- A drop of the bank's net interest margins to around 7.0%-7.5%, due to the predominance of low-margin corporate lending in the bank's portfolio, high interest payments on the Eurobond, and a positive effect of repricing loans following the increase in the monetary policy rate.
- A 70%/30% split between net interest income and noninterest income. Fee and commissions of 10%, with stronger income generation from selling and trading in foreign currencies for corporate customers. Zenith is a dominant player in this business, with a 25% share.
- A cost-to-income ratio in the 50%-55% range, which is weaker than other leading peers' and explained by the bank's wide branch network.
- A cost of risk of about 1.0% over the next 12-18 months.
- A dividend payout ratio of around 50% of net income.

We calculate the bank's earnings buffer at close to 1% of risk-weighted assets, which means that we expect Zenith's earnings to cover normalized losses. This measure is a stress test derived from our RAC framework, which is calibrated using, among other factors, an average level of credit losses (or normalized credit losses). The quality of Zenith's capital and earnings is good and compares adequately with that of domestic rated peers. The bank's adjusted common equity comprises 100% of total adjusted capital.

Table 3

Zenith Bank PLC Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2017***	**2016**	**2015**	**2014**	**2013**
Tier 1 capital ratio	21.5	21.6	21.2	19.8	26.0
S&P Global Ratings' RAC ratio before diversification	N/A	5.1	5.2	6.3	6.1
S&P Global Ratings' RAC ratio after diversification	N/A	3.9	4.3	5.3	5.0
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	54.0	66.1	73.0	69.8	71.6
Fee income/operating revenues	14.7	18.8	19.8	23.8	19.9
Market-sensitive income/operating revenues	27.6	14.8	6.8	6.1	8.2
Noninterest expenses/operating revenues	47.4	47.6	54.2	55.0	55.3
Preprovision operating income/average assets	5.6	4.4	3.6	3.9	4.1
Core earnings/average managed assets	3.1	3.0	2.7	2.9	3.2

*Data as of June 30. RAC--Risk-adjusted capital. N/A--Not applicable.

Table 4

Zenith Bank PLC Risk-Adjusted Capital Framework Data

(Mil. NGN)	**Exposure at default**	**Basel III RWA**	**Average Basel III RW (%)**	**S&P Global Ratings' RWA**	**Average S&P Global Ratings' RW (%)**
Credit risk					
Government and central banks	1,743,313	401,133	23	3,204,248	183.8
Institutions and CCPs	575,049	401,133	69.8	763,713	132.8
Corporate	2,519,394	1,203,400	47.8	6,021,756	239.0
Retail	340,561	--	--	752,324	220.9
Of which mortgage	--	--	--	--	--
Securitization*	--	--	--	--	--
Other assets§	119,973	401,133	334.4	405,145	337.7
Total credit risk	5,298,290	2,406,800	45.4	11,147,185	210.4
Credit valuation adjustment					
Total credit valuation adjustment	--	1	--	--	--
Market risk					
Equity in the banking book	16,652	--	--	187,335	1125.0
Trading book market risk	--	17,684	--	49,736	--
Total market risk	--	17,684	--	237,071	--
Operational risk					
Total operational risk	--	554,772	--	691,235	--
		Basel III RWA		**S&P Global Ratings' RWA**	**% of S&P Global Ratings' RWA**
Diversification adjustments					
RWA before diversification		2,979,257		12,075,491	100.0
Total Diversification/Concentration Adjustments		--		3,685,436	30.5

Table 4

Zenith Bank PLC Risk-Adjusted Capital Framework Data (cont.)				
RWA after diversification	2,979,257		15,760,927	130.5
	Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings' RAC ratio (%)**
Capital ratio				
Capital ratio before adjustments	642,511	21.6	619,009	5.1
Capital ratio after adjustments†	642,511	21.6	619,009	3.9

*Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. §Other assets includes deferred tax assets not deducted from adjusted common equity. †Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. NGN--Nigerian naira. Sources: Company data as of Dec. 31, 2016, S&P Global Ratings.

Risk position: Good loan loss experience and low concentration

Our assessment of Zenith's adequate risk position reflects Zenith's good low loan-loss track record versus domestic peers' and conservative risk management. We expect nonperforming loans to remain at 4%-5% in 2017, but decline gradually in subsequent years as the economy recovers.

Zenith's loan book is fairly diversified compared with that of other Nigerian banks, particularly given its corporate focus. We believe this attests to the strength of the bank's franchise and solid risk management. On Dec. 31, 2016, oil and gas exposures made up about 28% of total loans, which is lower than average in Nigeria.

We consider the high degree of foreign currency--predominantly assets and loans--as a key risk facing all Nigerian banks. On Dec. 31, 2016, a significant 41% of total loans was denominated in foreign currencies. However, Zenith's exposures are partly mitigated by extending foreign currency loans to firms that have foreign currency revenues or employ currency hedges.

Table 5

Zenith Bank PLC Risk Position					
		--Year-ended Dec. 31--			
(%)	**2017***	**2016**	**2015**	**2014**	**2013**
Growth in customer loans	(2.6)	16.2	15.6	37.8	25.8
Total managed assets/adjusted common equity (x)	7.2	7.7	7.6	7.8	7.0
New loan loss provisions/average customer loans	3.6	1.5	0.8	0.9	1.0
Net charge-offs/average customer loans	0.2	0.4	0.1	0.6	0.9
Gross nonperforming assets/customer loans + other real estate owned	4.3	3.0	2.2	1.7	2.4
Loan loss reserves/gross nonperforming assets	113.0	100.1	95.6	93.7	80.1

*Data as of June 30. N/A--Not applicable. RWA--Risk-weighted assets.

Funding and liquidity: Above-average funding and adequate liquidity

We view Zenith's funding as above average and liquidity as adequate. The bank's funding profile is dominated by customer core and stable customer deposits. On June 30, 2017, the bank's cost of funds (interest expense to average funding base) rose to 6.4% from 3.2% a year earlier, due to the increase in the Monetary Policy Rate and the issuance of its second Eurobond tranche in May 2017 of $500 million. Going forward, we expect the bank's retail expansion to drive deposit growth and moderate funding costs somewhat. On June 30, 2017, core deposits accounted for 58% of the funding base.

Like its Nigerian peers, Zenith runs a significant asset-liability mismatch. We assume this will increase as the bank pursues lower-cost demand deposits to reduce its cost of funds and improve its margins. Positively, the stable funding ratio was 123% on on June 30, 2017. Zenith's broad liquid assets covered 80% of short-term deposits and 14x wholesale funding on June 30, 2017.

We believe that Zenith's dollar liquidity risk has improved, given the increased availability of U.S. dollars in Nigeria, as well as the Eurobond issue. Zenith keeps a sizable cash cushion in foreign currencies covering about 15% of foreign currency deposits as of Dec. 31, 2016.

Table 6

Zenith Bank PLC Funding And Liquidity					
		--Year-ended Dec. 31--			
(%)	**2017***	**2016**	**2015**	**2014**	**2013**
Core deposits/funding base	57.9	63.4	65.1	67.9	80.3
Customer loans (net)/customer deposits	94.5	96.3	95.4	87.9	65.0
Long-term funding ratio	83.1	79.5	84.8	81.4	86.6
Stable funding ratio	123.4	111.9	117.2	120.7	142.0
Short-term wholesale funding/funding base	3.4	8.2	3.2	2.5	4.2
Broad liquid assets/short-term wholesale funding (x)	13.8	5.4	13.6	21.5	14.8
Net broad liquid assets/short-term customer deposits	74.0	56.8	62.5	75.1	72.1
Short-term wholesale funding/total wholesale funding	8.0	22.3	9.3	7.8	21.4
Narrow liquid assets/3-month wholesale funding (x)	15.1	9.5	15.8	22.9	15.3

*Data as of June 30.

Support: No notches of uplift to the SACP

The ratings on Zenith reflect its stand-alone credit profile (SACP) and do not incorporate any notches of uplift for external support.

Despite Zenith's high systemic importance to Nigeria, we do not provide uplift for support because we classify the Nigerian government support as uncertain, given what we see as a lack of capacity to provide U.S. dollar support to banks should it be necessary.

Additional rating factors: None

No additional factors affect this rating.

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Nigeria-Based Zenith Bank 'B/B' And 'ngBBB/ngA-2' Ratings Affirmed; Outlook Stable, Sept. 22, 2017
- Federal Republic of Nigeria Ratings Affirmed At 'B/B'; Outlook Stable, Sept. 15, 2017
- Nigeria Bank Outlook 2017: Economic And Currency Concerns Will Fuel Weaker Capital And Higher Credit Losses, Feb. 27, 2017
- Banking Industry Country Risk Assessment: Nigeria, Nov. 10, 2017

Regulatory Disclosures

Regulatory disclosures applicable to the most recent credit rating action can be found at "Nigeria-Based Zenith Bank 'B/B' And 'ngBBB/ngA-2' Ratings Affirmed; Outlook Stable," published Sept. 22, 2017, on RatingsDirect.

Glossary

- Anchor: The starting point for assigning a bank a long-term rating, based on economic and industry risk.
- Asset-liability mismatch: Occurs when financial terms of an institution's assets and liabilities do not correspond.
- Asset quality: A key measure of the quality and performance of the assets of a bank.
- Available stable funding: Core deposits, plus deposits due to banks (net of those that mature within one year), plus other borrowings (net of maturities within one year), plus total equity, minus intangibles.
- Broad liquid assets: cash (net of restricted cash) and reserves at central bank, plus other cash and money market, plus bank loans and reverse repos that mature in less than one year, plus total liquid assets.
- Business position: A measure of the strength of a bank's business operations.
- Capital and earnings: A measure of a bank's ability to absorb losses.
- Cost of funds: Interest expense as a percentage of average interest-bearing liabilities.
- Counterparty credit rating: A form of issuer credit rating, which is a forward-looking opinion about an obligor's overall creditworthiness.
- Credit losses: Losses arising from credit risk.
- Credit risk: Risk that a borrower will default on its payment obligations.
- Customer loans (gross): Total customer loans before loan loss reserves.
- Date initial rating assigned: The date S&P Global Ratings assigned the long-term foreign currency issuer credit rating on the entity.
- Date of previous review: The date S&P Global Ratings last reviewed the
- credit rating on the entity.
- Earning capacity: The capacity of a bank to generate sufficient earnings against losses and the primary way that a

bank builds or maintains its capitalization.

- Fee income over operating revenues: Net income on fees and commissions over operating revenues.
- Funding and liquidity: A combined assessment of the strength and stability of a bank's funding mix and its ability to manage its liquidity needs in adverse market and economic conditions over an extended period.
- Funding base: Total deposits, plus acceptances, repurchase agreements, and other borrowings (including commercial papers, short- and long-term debt, subordinated debt, and minimal equity content hybrids).
- Government-related entity (GRE) support: An assessment of the likelihood that the government would provide extraordinary support to a bank that is a government-related entity.
- Gross nonperforming assets over customer loans plus other real estate
- owned over customer loans: Nonaccrual loans, plus restructured loans, plus repossessed assets plus loans 90-days past due; over gross customer loans plus repossessed assets.
- Loan loss reserves over gross nonperforming assets: General plus specific reserves, over adjusted nonperforming assets (nonaccrual loans plus restructured loans plus repossessed assets plus 90-day past due loans).
- Long term funding ratio: Available stable funding, over funding base plus total equity, minus intangibles.
- National scale rating: An opinion of an obligor's creditworthiness or overall capacity to meet specific financial obligations, relative to other issuers and issues in a given country or region.
- New loan loss provisions over average customer loans: Credit loss provisions (including specific loan provisions and general and other provisions) minus recoveries, over average gross customer loans of current period and last fiscal year.
- Noninterest expenses: Salaries and general administrative expenses (including depreciations and amortizations).
- Operating revenues: Net interest income, plus operating non-interest income (that mainly includes fees and commissions and trading gains).
- Return on equity: Net income before extraordinary results minus preferred dividends over average common (average between current period and last fiscal period).
- Risk position: Our view of the specific risk characteristics of a particular bank.
- Risk-adjusted capital (RAC) ratio before diversification: This is calculated according to S&P Global Ratings' methodology as total adjusted capital over risk-adjusted assets.
- Short-term wholesale funding: Debt securities that mature in less than one year (of commercial papers, debt and senior and subordinated bonds), plus bank deposits that mature in less than one year.
- Sovereign support: An assessment of the likelihood that the government would provide extraordinary support to a bank.
- Stable funding needs: Restricted cash and reserves at the central bank, plus interbank deposits, plus loans to banks (net of maturities within one year), plus reverse repurchase agreements, plus gross customer loans net of loan-loss reserves, plus securities, minus total liquid securities, plus equity participations in nonfinancial entities, plus fixed assets, plus other assets (considering foreclosed assets, tax loss carryforwards, and deferred assets).
- Stable funding ratio: Available stable funding over stable funding needs.
- Stand-alone credit profile (SACP): An interim step in assessing a bank's overall creditworthiness. It includes government support, but not extraordinary government support.
- Total adjusted capital: Adjusted common equity plus admissible preferred instruments and hybrids.

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	**10**
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	**b**
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of January 16, 2018)

Zenith Bank PLC	
Counterparty Credit Rating	B/Stable/B
Nigeria National Scale	ngBBB/--/ngA-2
Senior Unsecured	B
Short-Term Debt	B
Counterparty Credit Ratings History	
22-Sep-2016	B/Stable/B
24-Mar-2016	B+/Negative/B
25-Mar-2015	B+/Stable/B
13-Feb-2015	BB-/Watch Neg/B
01-Apr-2014	BB-/Negative/B
22-Sep-2016 *Nigeria National Scale*	ngBBB/--/ngA-2
24-Mar-2016	ngA-/--/ngA-2
25-Mar-2015	ngA/--/ngA-1
13-Feb-2015	ngAA-/Watch Neg/ngA-1
Sovereign Rating	
Nigeria (Federal Republic of)	B/Stable/B
Nigeria National Scale	ngBBB/--/ngA-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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