Cytonn INVESTMENTS

Diamond Trust Bank Earnings Note- H1'2019

21st August, 2019

Valuation Summary

- We are of the view that Diamond Trust Bank is a "Buy" with a target price of Kshs 155.1, representing an upside of 33.9%, from the current price of Kshs 119.0 as of 21st August, inclusive of a dividend yield of 2.2%,
- DTB is currently trading at P/TBV of 0.6x and a P/E of 4.9x vs an industry average of 1.0x and 7.1x, respectively.

Key Highlights H1'2019

- DTB launched a financial literacy programme for Micro, Small and Medium Enterprises (MSMEs) in June 2019, with an aim to impart skills to enable more MSMEs run their businesses effectively and take advantage of the finance opportunities offered by commercial banks. The programme's objective was to build capacity of MSMEs in financial and human resources management, strategic planning, marketing and communication, and offer training on various financial products and services available to help them grow their businesses.

Income Statement:

- Diamond Trust Bank released their H1'2019 results during the week, with core earnings per share growing by 11.0% to Kshs 13.9 from Kshs 12.5 in H1'2018, higher than our expectation of a 6.3% increase to Kshs 13.3. Performance was driven by cost-cutting measures and efficiency evidenced by a 14.4% decrease in total operating expenses to Kshs 6.2 bn from Kshs 7.3 bn, which outpaced the decline in total revenue that fell 4.0% to Kshs 12.2 bn from Kshs 12.7 bn. The variance in core earnings per share growth relative to our expectations, was as a result of a faster growth in Non-Funded Income (NFI) of 8.5% to Kshs 3.0 bn, from Kshs 2.7 bn in H1'2018 against our expectation of a 1.9% increase to Kshs 2.8 bn. Highlights of the performance from H1'2018 to H1'2019 include:
- Total operating income decreased by 4.0% to Kshs 12.2 bn, from Kshs 12.7 bn in H1'2018. This was due to a 7.5% decrease in Net Interest Income (NII) to Kshs 9.2 bn from Kshs 9.9 bn in H1'2018, that outpaced the 8.5% growth in Non-Funded Income (NFI) to Kshs 3.0 bn, from Kshs 2.7 bn in H1'2018,
- Interest income decreased by 6.6% to Kshs 16.3 bn from Kshs 17.5 bn in H1'2018. The interest income on loans and advances decreased by 10.4% to Kshs 9.9 bn from Kshs 11.1 bn in H1'2018. Interest income on government securities decreased by 0.6% to Kshs 6.27 bn in H1'2019, from Kshs 6.31 bn in H1'2018. The yield on interest earning assets declined to 10.3% in H1'2019, from 11.1% in H1'2018, due to declining yields on government securities and a relatively lower Central Bank Rate (CBR) currently at 9.0%,
- Interest expense decreased by 5.5% to Kshs 7.2 bn from Kshs 7.6 bn in H1'2018, as interest expense on customer deposits decreased by 11.4% to Kshs 6.1 bn, from Kshs 6.8 bn in H1'2018. Interest expense on deposits from other banking institutions increased by 6.1% to Kshs 394.6 mn, from Kshs 371.9 mn in H1'2018. The cost of funds decreased to 4.8%, from 5.0% in H1'2018. The Net Interest Margin declined to 5.8%, from 6.3% in H1'2018,
- Non-Funded Income increased by 8.5% to Kshs 3.0 bn, from Kshs 2.7 bn in H1'2018. The increase in NFI was driven by a 59.1% increase in other income to Kshs 0.3 bn from Kshs 0.2 bn in H1'2018, coupled with a 25.3% increase in forex trading income to Kshs 1.0 bn from Kshs 0.8 bn in H1'2018. Fees and commissions on loans decreased by 15.6% to Kshs 0.6 bn from Kshs 0.7 bn in H1'2018, while other fees rose marginally by 2.1% to Kshs 1.1 bn from Kshs 1.0

bn in H1'2018. The revenue mix shifted to 76:24 funded to non-funded income in H1'2019, from 78:22 in H1'2018, owing to the increase in NFI coupled with the decrease in NII,

- Total operating expenses decreased by 14.4% to Kshs 6.2 bn from Kshs 7.3 bn, largely driven by a 68.1% decrease in loan loss provision (LLP) to Kshs 0.5 bn in H1'2019, from Kshs 1.7 bn in H1'2018. However, staff costs increased by 6.2% to Kshs 2.2 bn in H1'2019, from Kshs 2.1 bn in H1'2018. Other operating expenses declined by 1.1% to Kshs 3.47 bn from Kshs 3.51 bn in H1'2018,
- The cost to income ratio improved to 51.2%, from 57.4% in H1'2018. Without LLP, however, the cost to income ratio deteriorated to 46.8% from 44.2% in H1'2018,
- Profit before tax increased by 10.2% to Kshs 6.0 bn, up from Kshs 5.4 bn in H1'2018. Profit after tax increased by 10.0% to Kshs 4.1 bn in H1'2019, from Kshs 3.8 bn in H1'2018, as the effective tax rate declined by 2.5% points to 30.6%, from 33.1% in H1'2018.

Balance Sheet:

- The balance sheet recorded a marginal decrease with total assets coming in at Kshs 375.9 bn from Kshs 376.1 bn in H1'2018. This decrease was largely driven by a 14.4% decrease in government securities to Kshs 108.4 bn in H1'2019, from Kshs 126.8 bn in H1'2018.
- The loan book contracted by 3.8% to Kshs 190.8 bn in H1'2019, from Kshs 198.2 bn in H1'2018. Growth was registered in other assets which grew by 59.4% to Kshs 13.4 bn, from Kshs 8.4 bn in H1'2018,
- Total liabilities fell by 2.4% to Kshs 313.4 bn, from Kshs 321.1 bn in H1'2018, driven by a 53.6% decrease in placements to Kshs 8.7 bn, from Kshs 18.7 bn in H1'2018, coupled with a 22.0% decrease in borrowings to Kshs 13.2 bn, from Kshs 16.9 bn in H1'2018.
- Deposits increased by 0.5% to Kshs 283.1 bn from Kshs 281.8 in H1'2018. Deposit per branch increased by 5.1% to Kshs 2.2 bn from Kshs 2.1 bn in H1'2018, with the branches decreasing to 131 in H1'2019 from 137 in H1'2018,
- The faster growth in deposits compared to the loan growth led to a decline in the loan to deposit ratio to 67.4% from 70.4% in H1'2018,
- Gross non-performing loans decreased by 1.0% to Kshs 15.1 bn in H1'2019, from Kshs 15.3 bn in H1'2018. However, the NPL ratio deteriorated to 7.6% in H1'2019, from 7.3% in H1'2018, owing to the faster decline in loans, which contracted by 3.8%. General loan loss provisions decreased by 36.7% to Kshs 5.4 bn, from Kshs 8.5 bn in H1'2018. The NPL coverage thus decreased to 50.3% in H1'2019, from 70.7% in H1'2018 due to the decrease in general loan loss provisions,
- Shareholders' funds increased by 13.9% to Kshs 56.9 bn in H1'2019, from Kshs 50.0 bn in H1'2018,
- DTB Kenya Limited is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 18.9%, 8.4% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 21.1%, exceeding the statutory requirement by 6.6%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 19.6%, while total capital to risk weighted assets came in at 21.8%, indicating that the bank's total capital relative to its risk-weighted assets decreased by 0.7% due to the impact of IFRS 9,
- DTB currently has a return on average assets of 2.0% and a return on average equity of 13.9%.

Key Take-Outs:

a. The bank recorded a relatively weaker earnings performance with total operating income declining by 4.0%. This was largely due to the depressed performance of funded income, with the bank recording declining interest income on loans and advances and government securities. The expansion from the bottom line was largely due to a faster decline in total operating expenses, which was largely derived from the steep 68.1% decline in Loan Loss Provisions (LLP).
b. The bank recorded an improved performance on the NFI income segment, which recorded an 8.5% growth y/y, largely supported by the 59.1% growth in other income, coupled with the 25.3% growth in forex trading income. Consequently, NFI contribution to total income rose to 24.5% from 22.6% in H1’2019. This however remains below the current industry average of 36.0%.

Going forward, we expect the bank’s growth to be further driven by:

a. **Regional Diversification**: We continue to expect DTBK’s increased regional presence to aid in enhancing growth. We expect DTBK’s increased focus on other regions to boost the growth in the bottom line, largely supported by the expansion of funded income which has remained subdued largely due to the pricing restriction existent in Kenya. A diversification into other regions would aid the bank in mitigating the sustained effects of compressed margins,
b. **Operational Efficiency**: DTBK continues to be one of the most efficient banks, and as at H1’2019, had a cost to income ratio of 51.2%, which was below the market average of 55.4%. Thus, DTBK’s continued focus on maintaining high operational margins coupled with an expanding top line revenue growth will likely lead to consistent growth in the long run.

Below is a summary of the bank’s performance;

Balance Sheet Items	H1'2018	H1'2019	y/y change	Q1'2019e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	129.2	120.7	(6.5%)	119.7	(7.4%)	0.8%
Net Loans and Advances	198.2	190.8	(3.8%)	191.6	(3.4%)	(0.4%)
Total Assets	**376.1**	**375.9**	**(0.0%)**	**380.3**	**1.1%**	**(1.2%)**
Customer Deposits	281.7	283.1	0.5%	279.5	(0.8%)	1.3%
Total Liabilities	321.8	314.1	(2.4%)	317.7	(1.3%)	(1.1%)
Shareholders’ Funds	**50.0**	**56.9**	**13.9%**	**57.3**	**14.6%**	**(0.8%)**

Balance Sheet Ratios	H1'2018	H1'2019	y/y change
Loan to Deposit Ratio	70.4%	67.4%	(3.0%)
Return on average equity	15.5%	13.9%	(1.6%)
Return on average assets	2.0%	2.0%	(0.0%)

Income Statement	H1'2018	H1'2019	y/y change	Q1'2019e	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	9.9	9.2	(7.5%)	9.7	(2.2%)	(5.3%)
Net non-Interest Income	2.7	3.0	8.5%	2.8	1.9%	6.6%
Total Operating income	**12.67**	**12.16**	**(4.0%)**	**12.5**	**(1.3%)**	**(2.7%)**

Loan Loss provision	1.7	0.5	(68.1%)	1.1	(32.9%)	(35.2%)
Total Operating expenses	7.3	6.2	(14.4%)	6.8	(6.0%)	(8.5%)
Profit before tax	**5.4**	**6.0**	**10.2%**	**5.7**	**5.0%**	**5.2%**
Profit after tax	**3.8**	**4.1**	**10.0%**	**3.9**	**2.7%**	**7.3%**

Income Statement Ratios	H1'2018	H1'2019	y/y change
Yield from interest-earning assets	11.0%	10.3%	(0.7%)
Cost of funding	5.0%	4.8%	(0.2%)
Net Interest Spread	6.0%	5.5%	(0.5%)
Net Interest Income as % of operating income	78.4%	75.5%	(2.8%)
Non-Funded Income as a % of operating income	21.6%	24.5%	2.8%
Cost to Income Ratio (CIR)	57.4%	51.2%	(6.3%)
CIR without provisions	44.2%	46.8%	2.6%
Cost to Assets	4.2%	3.6%	(0.6%)
Net Interest Margin	6.3%	5.8%	(0.4%)

Capital Adequacy Ratios	H1'2018	H1'2019
Core Capital/Total Liabilities	17.5%	20.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**9.5%**	**12.3%**
Core Capital/Total Risk Weighted Assets	17.4%	18.9%
Minimum Statutory ratio	10.5%	10.5%
Excess	**6.9%**	**8.4%**
Total Capital/Total Risk Weighted Assets	18.7%	21.1%
Minimum Statutory ratio	14.5%	14.5%
Excess	**4.2%**	**6.6%**
Liquidity Ratio	51.1%	54.3%
Minimum Statutory ratio	20.0%	20.0%
Excess	**31.1%**	**34.3%**