Diamond Trust Bank Limited Earnings Update – Q3'2018

23rd November, 2018

Valuation Summary

- We are of the view that Diamond Trust Bank is a "**Buy**" with a target price of Kshs 283.7, representing an upside of 94.3%, from the current price of Kshs 146.0 as of 23rd November, inclusive of a dividend yield of 1.8%,
- DTB is currently trading at P/TBV of 0.8x and a P/E of 6.1x vs an industry average of 1.4x and 6.7x, respectively.

Income Statement

- Core earnings per share grew by 10.0% to Kshs 20.2 from Kshs 18.3 in Q3'2017, which was in line with our projections of a 10.3% growth. Performance was driven by a 3.6% increase in operating income to Kshs 19.0 bn from Kshs 18.4 bn in Q3'2017, coupled with a 0.1% decline in operating expenses to Kshs 10.8 bn from Kshs 10.9 bn,
- Total operating income increased by 3.6% to Kshs 19.0 bn, from Kshs 18.4 bn in Q3'2017. This was due to a 2.9% increase in Net-Interest Income (NII) to Kshs 14.9 bn, from Kshs 14.5 bn in Q3'2017, coupled with a 6.3% increase in Non-Funded Income (NFI) to Kshs 4.1 bn, from Kshs 3.9 bn in Q3'2017,
- Interest income increased by 3.0% to Kshs 26.5 bn from Kshs 25.7 bn in Q3'2017. This was driven by an 11.1% rise in Interest income on government securities, to Kshs 9.7 bn in Q3'2018 from Kshs 8.7 bn in Q3'2017. Interest income on loans and advances however declined by 1.5% to Kshs 16.5 bn from Kshs 16.8 bn in Q3'2017. The yield on interest earning assets declined to 10.8% in Q3'2018, from 11.4% in Q3'2017, due to the relatively faster growth in interest-earning assets by 8.7% to Kshs 341.7 bn, from Kshs 314.3 bn in Q3'2017, with the increase mainly driven by government securities that increased by 17.7% to Kshs 128.3 bn, from Kshs 109.0 bn in Q3'2017. The decline in the yield on interest earning assets also led to a decline in the Net Interest Margin to 6.1%, from 6.4% recorded in Q3'2017,
- Interest expense increased by 3.0% to Kshs 11.6 bn from Kshs 11.2 bn in Q3'2017, as interest expense on customer deposits increased by 1.2% to Kshs 10.3 bn from Kshs 10.1 bn in Q3'2017. Interest expense on deposits from other banking institutions increased by 60.2% to Kshs 628.5 mn, from Kshs 392.3 mn in Q3'2017. The cost of funds declined to 4.9% from 5.2% in Q3'2017, owing to the faster increase in interest-bearing liabilities by 8.1% to Kshs 324.1 bn, from Kshs 299.7 bn in Q3'2017, compared with the 3.0% increase in interest expense,
- Non-Funded Income increased by 6.3% to Kshs 4.1 bn from Kshs 3.9 bn in Q3'2017. The increase in NFI was driven by a 7.7% increase in fees and commissions on loans to Kshs 1.0 bn from Kshs 0.9 bn, coupled with a 7.2% increase in other fees and commission income to Kshs 1.6 bn from Kshs 1.5 bn in Q3'2017. Forex trading income also rose albeit marginally, by 2.8% to Kshs 1.19 bn from Kshs 1.16 bn in Q3'2017. The revenue mix shifted to 78:22 funded to non-funded income in Q3'2018 from 79:21 in Q3'2017, owing to the faster increase in NFI compared to NII,
- Total operating expenses declined marginally by 0.1% to Kshs 10.84 bn from Kshs 10.85 bn, largely driven by a 17.3% decline in loan loss provisions to Kshs 2.4 bn in Q3'2018 from Kshs 2.9 bn in Q3'2017, despite staff costs increasing by 4.3% to Kshs 3.1 bn in Q3'2018 from Kshs 3.0 bn in Q3'2017,
- The cost to income ratio improved to 56.9% from 59.1% in Q3'2017. Without LLP, however, the cost to income ratio deteriorated to 44.4% from 43.3% in Q3'2017,
- Profit before tax increased by 9.1% to Kshs 8.2 bn, up from Kshs 7.5 bn in Q3'2017. Profit after tax increased by 10.0% to Kshs 5.6 bn in Q3'2018 from Kshs 5.1 bn in Q3'2017.

Balance Sheet

- The balance sheet recorded an expansion with total assets recording a growth of 7.8% to Kshs 385.0 bn from Kshs 357.2 bn in Q3'2017. This growth was largely driven by a 17.7% increase in government securities to Kshs 128.3 bn in Q3'2018 from Kshs 109.0 bn in Q3'2017,
- The loan book expanded by 0.7% to Kshs 197.7 bn in Q3'2018 from 196.3 bn in Q3'2017,
- Total liabilities rose by 7.4% to Kshs 328.0 bn from Kshs 305.2 bn in Q3'2017, driven by a 6.5% increase in customer deposits to Kshs 282.2 bn from Kshs 265.1 bn in Q3'2017. Deposit per branch also grew by 6.5% to Kshs 2.0 bn from Kshs 1.9 bn, with no new branch openings/closures,
- The faster growth in deposits compared with loan growth led to a decline in the loan to deposit ratio to 70.0%, from 74.1% in Q3'2017. The proportion of government securities to deposits rose to 45.4% from 41.1% in Q3'2017,
- Gross non-performing loans declined by 1.4% to Kshs 16.3 bn in Q3'2018 from Kshs 16.6 bn in Q3'2017. Consequently, the NPL ratio improved to 7.7% in Q3'2018, from 8.0% in Q3'2017. General loan loss provisions increased by 40.8% to Kshs 9.3 bn from Kshs 6.6 bn in Q3'2017. As a result, the NPL coverage improved to 72.5% from 54.9% in Q3'2017,
- Shareholders' funds increased by 11.0% to Kshs 51.9 bn in Q3'2018, from Kshs 46.7 bn in Q3'2017, driven by a 4.6% increase in retained earnings to Kshs 41.0 bn, from Kshs 34.6 bn in Q3'2017,
- DTB is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 17.8%, 7.3% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 19.1%, exceeding the statutory requirement by 4.6% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 18.8%, while total capital to risk-weighted assets came in at 20.1%, indicating that the bank's total capital relative to its risk-weighted assets declined by 1.0% due to implementation of IFRS 9,
- DTB currently has a Return on Average Assets (RoAA) of 1.8% and a Return on Average Equity (RoAE) of 13.3%.

Key Take-Outs:

a) The asset quality of DTB improved, with gross NPLs declining by 1.4% to Kshs 16.3 bn from Kshs 16.6 bn in the period under review, with the NPL ratio declining to 7.7% from 8.0% a year earlier. The 40.8% increase in the general loss provisions led to an improvement in the NPL coverage to 72.5%, due to the increase in the general loss provisions coupled with a 1.4% decline in non-performing loans.
b) The bank managed to improve on its operational efficiency as the CIR improved to 56.9% from 59.1% in Q3'2017. However, this seems to have stemmed from a lower cost of risk on reduced provisioning, as the CIR without LLP deteriorated to 44.4 from 43.3% in Q3'2017.

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

- Non-Funded Income Growth Initiatives – DTB's partnership with the Postal Corporation of Kenya has expanded its agency banking reach across the country. This is expected to increase transactional volumes, which will in turn contribute to NFI generation through fees and commissions. DTB should also increase the capacity of its bancassurance business to acquire more customers through cross-selling insurance products to existing customers.
- Better underwriting of loans to ascertain and minimize risks associated with every market segment in which it operates, in order to improve the bank's asset quality. The bank obtained a 7-year, Kshs 7.6 bn credit facility from AfDB, which it will use to extend credit to SME businesses which will go a long way in improving the asset-liability tenor mismatch

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Balance Sheet Items	Q3'2017	Q3'2018	y/y change	Q3'2018e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	109.0	128.3	17.7%	126.8	16.4%	1.4%
Net Loans and Advances	196.3	197.7	0.7%	201.9	2.9%	(2.2%)
Total Assets	**357.2**	**385.0**	**7.8%**	**381.3**	**6.8%**	**1.0%**
Customer Deposits	265.0	282.2	6.5%	282.2	6.5%	0.0%
Total Liabilities	305.3	328.0	7.4%	324.2	6.2%	1.3%
Shareholders' Funds	**46.7**	**51.9**	**11.0%**	**52.2**	**11.6%**	**(0.6%)**

Balance Sheet Ratios	Q3'2017	Q3'2018	y/y change
Loan to Deposit Ratio	74.1%	70.0%	(4.0%)
Return on average equity	17.8%	13.3%	(4.5%)
Return on average assets	3.1%	1.8%	(1.3%)

Income Statement	Q3'2017	Q3'2018	y/y change	Q3'2018e	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	14.5	14.9	2.9%	15.0	3.5%	(0.6%)
Net non-Interest Income	3.9	4.1	6.3%	4.2	7.1%	(0.8%)
Total Operating income	18.37	19.03	3.6%	19.1	4.2%	(0.6%)
Loan Loss provision	2.9	2.4	(17.3%)	2.2	(24.3%)	7.1%
Total Operating expenses	10.9	10.8	(0.1%)	10.7	(1.3%)	1.2%
Profit before tax	7.5	8.2	9.1%	8.4	12.3%	(3.2%)
Profit after tax	5.1	5.6	10.0%	5.7	10.3%	(0.3%)

Income Statement Ratios	Q3'2017	Q3'2018	y/y change
Yield from interest-earning assets	11.4%	10.8%	(0.6%)
Cost of funding	5.2%	4.9%	(0.3%)
Net Interest Spread	6.2%	5.9%	(0.3%)
Net Interest Income as % of operating income	79%	78%	(0.6%)
Non-Funded Income as a % of operating income	21%	22%	0.6%
Cost to Income Ratio (CIR)	59.1%	56.9%	(2.2%)
CIR without provisions	43.3%	44.4%	1.0%
Cost to Assets	4.1%	4.0%	(0.1%)
Net Interest Margin	6.4%	6.1%	(0.3%)

Capital Adequacy Ratios	Q3'2017	Q3'2018
Core Capital/Total Liabilities	17.5%	18.0%
Minimum Statutory ratio	8.0%	8.0%
Excess	**9.5%**	**10.0%**
Core Capital/Total Risk Weighted Assets	16.5%	17.8%
Minimum Statutory ratio	10.5%	10.5%
Excess	**6.0%**	**7.3%**
Total Capital/Total Risk Weighted Assets	18.4%	19.1%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.9%**	**4.6%**

Liquidity Ratio	51.2%	51.9%
Minimum Statutory ratio	20.0%	20.0%
Excess	**31.2%**	**31.9%**
Adjusted core capital/ total deposit liabilities*		19.3%
Adjusted core capital/ total risk weighted assets*		18.8%
Adjusted total capital/ total risk weighted assets*		20.1%

**Adjusted ratios inline with CBK's guidance note, allowing the addition of provisions for capital computation purposes*