Valuation Summary

- We are of the view that Diamond Trust Bank is a “Buy” with a target price of Kshs 215.3, representing an upside of 89.4%, from the current price of Kshs 115.0 as at 29th November 2019, inclusive of a dividend yield of 2.3%,
- DTB is currently trading at P/TBV of 0.6x and a P/E of 4.3x vs an industry average of 1.4x and 7.2x, respectively.

Key Highlights Q3’2019

- None

Income Statement:

- Diamond Trust Bank released its Q3’2019 results during the week, with core earnings per share growing by 7.5% to Kshs 20.2 from Kshs 18.8 in Q3’2018, lower than our expectation of a 13.3% increase to Kshs 21.3. Performance was driven by cost-cutting measures and efficiency evidenced by a 12.5% decrease in total operating expenses to Kshs 9.5 bn from Kshs 10.8 bn, which outpaced the decline in total operating that fell by 4.6% to Kshs 18.2 bn from Kshs 19.0 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 5.7% to Kshs 4.37 bn, from Kshs 4.1 bn in Q3’2018 against our expectation of a 6.2% increase to Kshs 4.39 bn. Highlights of the performance from Q3’2018 to Q3’2019 include:
- Total operating income decreased by 4.6% to Kshs 18.2 bn, from Kshs 19.0 bn in Q3’2018. This was due to a 7.5% decrease in Net Interest Income (NII) to Kshs 13.8 bn from Kshs 14.9 bn in Q3’2018, that outpaced the 5.7% growth in Non-Funded Income (NFI) to Kshs 4.4 bn, from Kshs 4.1 bn in Q3’2018,
- Interest income decreased by 7.3% to Kshs 24.5 bn from Kshs 26.5 bn in Q3’2018. The interest income on loans and advances decreased by 10.2% to Kshs 14.8 bn from Kshs 16.5 bn in Q3’2018. Interest income on government securities decreased by 3.9% to Kshs 9.3 bn in Q3’2019, from Kshs 9.7 bn in Q3’2018. The yield on interest earning assets declined to 9.9% in Q3’2019, from 10.8% in Q3’2018, due to the decline recorded in total interest earning assets by 2.3%, to Kshs 333.8 bn from Kshs 341.7 coupled with the decline in interest income sustained from a low interest rate environment,
- Interest expense decreased by 7.0% to Kshs 10.7 bn from Kshs 11.6 bn in Q3’2018, as interest expense on customer deposits decreased by 10.7% to Kshs 9.2 bn, from Kshs 10.3 bn in Q3’2018. Other interest expense increased by 54.9% to Kshs 1.0 bn, from Kshs 664.4 mn in Q3’2018. Consequently, cost of funds decreased to 4.6%, from 4.9% in Q3’2018 due to the decline recorded in total interest bearing liabilities by 4.4% to Kshs 309.9 bn from Kshs 324.7 bn recorded in Q3’2018. The Net Interest Margin, resultantly, declined to 5.6%, from 6.1% in Q3’2018,
- Non-Funded Income increased by 5.7% to Kshs 4.4 bn, from Kshs 4.1 bn in Q3’2018. The increase in NFI was driven by a 41.2% increase in forex trading income to Kshs 1.4 bn from Kshs 1.2 bn in Q3’2018, coupled with a 25.1% increase in other income to Kshs 0.44 bn from Kshs 0.35 bn in Q3’2018. Fees and commissions on loans however decreased by 4.6% to Kshs 0.96 bn from Kshs 1.0 bn in Q3’2018, while other fees fell marginally by 1.2% to Kshs 1.57 bn from Kshs 1.58 bn in Q3’2018. The revenue mix shifted to 76:24 funded to non-funded income in Q3’2019, from 78:22 in Q3’2018, owing to the increase in NFI coupled with the decrease in NII,
- Total operating expenses decreased by 12.5% to Kshs 9.5 bn from Kshs 10.8 bn, largely driven by a 63.7% decrease in loan loss provision (LLP) to Kshs 870.3 mn in Q3’2019, from Kshs 2.4 bn in Q3’2018. The decline was however mitigated by the 8.5% increase in staff costs to Kshs 3.4 bn in Q3’2019, from Kshs 3.1 bn in Q3’2018,

- Due to the faster 12.5% decline in total operating expenses that outpaced the 4.6% decline in total operating income, the cost to income ratio improved to 52.2%, from 56.9% in Q3'2018. Without LLP, however, the cost to income ratio deteriorated to 47.4% from 44.4% in Q3'2018,
- Profit before tax increased by 5.8% to Kshs 8.7 bn, up from Kshs 8.2 bn in Q3'2018. Profit after tax increased by 6.5% to Kshs 6.0 bn in Q3'2019, from Kshs 5.6 bn in Q3'2018, as the effective tax rate declined to 31.0%, from 31.3% in Q3'2018.

Balance Sheet:

- The balance sheet recorded a contraction as total assets declined by 0.6% to Kshs 382.5 bn from Kshs 385.0 bn in Q3'2018. This decrease was largely driven by a 1.2% decrease in government securities to Kshs 97.5 bn in Q3'2019, from Kshs 98.7 bn in Q3'2018, coupled with a 2.9% contraction of the loan book to Kshs 192.0 bn in Q3'2019, from Kshs 197.7 bn in Q3'2018. The decline was however mitigated by the 55.8% growth in other assets to Kshs 14.4 bn, from Kshs 9.3 bn in Q3'2018,
- Total liabilities declined by 3.1% to Kshs 317.8 bn, from Kshs 328.0 bn in Q3'2018, driven by a 47.1% decrease in placements to Kshs 14.3 bn, from Kshs 27.0 bn in Q3'2018, coupled with a 15.8% decrease in borrowings to Kshs 12.6 bn, from Kshs 14.9 bn in Q3'2018,
- Deposits however increased by 0.3% to Kshs 283.1 bn from Kshs 282.2 in Q3'2018. Deposit per branch increased marginally by 0.3% to Kshs 2.07 bn from Kshs 2.06 bn in Q3'2018, with the branch network remaining unchanged at 137 in Q3'2019,
- The faster growth in deposits compared to the decline recorded in loans led to a decline in the loan to deposit ratio to 67.8% from 70.0% in Q3'2018,
- Gross non-performing loans increased by 9.6% to Kshs 17.9 bn in Q3'2019, from Kshs 16.3 bn in Q3'2018. The NPL ratio thus deteriorated to 8.9% in Q3'2019, from 7.8% in Q3'2018. General loan loss provisions recorded a 38.4% decline to Kshs 5.7 bn, from Kshs 9.3 bn in Q3'2018. The NPL coverage, thus, decreased to 48.0% in Q3'2019, from 72.5% in Q3'2018 due to the decrease in general loan loss provisions,
- Shareholders' funds increased by 13.6% to Kshs 58.9 bn in Q3'2019, from Kshs 51.9 bn in Q3'2018, due to earnings retained since DTBK did not declare any interim dividends
- DTB Kenya Limited is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 19.1%, 8.6% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 21.2%, exceeding the statutory requirement by 6.7%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 19.8%, 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 0.6% due to the impact of IFRS 9,
- DTB Kenya currently has a return on average assets of 1.9% and a return on average equity of 13.4%.

Key Take-Outs:

a. The bank recorded a relatively weaker earnings performance with total operating income declining by 4.6%. 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 63.7% decline in Loan Loss Provisions (LLP).
b. The bank recorded an improved performance on the NFI income segment, which recorded a 5.7% growth y/y, largely supported by the 41.2% increase in forex trading income, coupled with a 25.1%

growth in other income. Consequently, NFI contribution to total income rose to 24.1% from 21.7% in Q3'2019. 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. 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 Q3'2019, had a cost to income ratio of 52.2%, which was below the market average of 56.7%. 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	Q3'2018	Q3'2019	y/y change	Q3'2019e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	128.3	127.5	(0.6%)	124.8	(2.7%)	2.2%
Net Loans and Advances	197.7	192.0	(2.9%)	193.7	(2.0%)	(0.9%)
Total Assets	**385.0**	**382.5**	**(0.6%)**	**391.5**	**1.7%**	**(2.3%)**
Customer Deposits	282.2	283.1	0.3%	293.5	4.0%	(3.7%)
Total Liabilities	328.0	317.8	(3.1%)	326.9	(0.3%)	(2.8%)
Shareholders' Funds	**51.9**	**58.9**	**13.6%**	**59.0**	**13.7%**	**(0.2%)**

Balance Sheet Ratios	Q3'2018	Q3'2019	y/y change
Loan to Deposit Ratio	70.0%	67.8%	(2.2%)
Return on average equity	15.1%	14.6%	(0.5%)
Return on average assets	2.0%	2.1%	0.1%

Income Statement	Q3'2018	Q3'2019	y/y change	Q3'2019e	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	14.9	13.8	(7.5%)	15.2	2.1%	(9.6%)
Net non-Interest Income	4.1	4.4	5.7%	4.4	6.2%	(0.5%)
Total Operating income	**19.03**	**18.15**	**(4.6%)**	**19.61**	**3.0%**	**(7.6%)**
Loan Loss provision	2.4	0.9	(63.7%)	1.7	(27.9%)	(35.8%)
Total Operating expenses	10.8	9.5	(12.5%)	10.5	(3.0%)	(9.5%)
Profit before tax	**8.2**	**8.7**	**5.8%**	**9.1**	**10.9%**	**(5.1%)**
Profit after tax	**5.6**	**6.0**	**6.5%**	**6.2**	**9.8%**	**(3.3%)**

Income Statement Ratios	Q3'2018	Q3'2019	y/y change
Yield from interest-earning assets	10.8%	9.9%	(0.9%)
Cost of funding	4.9%	4.6%	(0.3%)
Net Interest Spread	5.9%	5.3%	(0.6%)
Net Interest Income as % of operating income	78.3%	75.9%	(2.4%)
Non-Funded Income as a % of operating income	21.7%	24.1%	2.4%
Cost to Income Ratio (CIR)	56.9%	52.2%	(4.7%)

CIR without provisions	44.4%	47.4%	3.1%
Cost to Assets	4.0%	3.4%	(0.6%)
Net Interest Margin	6.1%	5.6%	(0.5%)

Capital Adequacy Ratios	Q3'2018	Q3'2019
Core Capital/Total Liabilities	15.8%	21.0%
Minimum Statutory ratio	8.0%	8.0%
Excess	**7.8%**	**13.0%**
Core Capital/Total Risk Weighted Assets	26.2%	19.1%
Minimum Statutory ratio	10.5%	10.5%
Excess	**15.7%**	**8.6%**
Total Capital/Total Risk Weighted Assets	33.8%	21.2%
Minimum Statutory ratio	14.5%	14.5%
Excess	**19.3%**	**6.7%**
Liquidity Ratio	51.9%	55.6%
Minimum Statutory ratio	20.0%	20.0%
Excess	**31.9%**	**35.6%**