Diamond Trust Bank Kenya Earnings Note– Q1’2019

29th May, 2019

Valuation Summary

- We are of the view that Diamond Trust Bank Kenya is a “***buy***” with a target price of Kshs 241.5, representing an upside of 100.1%, from the current price of Kshs 122 as of 29th May 2019, inclusive of a dividend yield of 2.1%,
- Diamond Trust Bank Kenya is currently trading at a P/TBV of 0.6x and a P/E of 5.0x vs an industry average of 1.2x and 6.3x, respectively.

Income Statement

- Earnings per share increased by 9.3% to Kshs 7.0 from Kshs 6.4 in Q1’2018, in line with our expectation of a 9.7% increase to Kshs 7.1. The performance was driven by the 9.7% decline in total operating expenses to Kshs 3.2 bn from Kshs 3.5 bn in Q1’2018,
- Total operating income declined by 1.9% to Kshs 6.1 bn, from Kshs 6.2 bn in Q1’2018. This was due to the 6.6% decline in Net Interest Income (NII) to Kshs 4.5 bn, from Kshs 4.9 bn in Q1’2018, which outweighed the 15.3% increase in Non-Funded Income (NFI) to Kshs 1.5 bn, from Kshs 1.3 bn in Q1’2018,
- Interest income declined by 5.1% to Kshs 8.2 bn, from Kshs 8.6 bn in Q1’2018. This was caused by the 10.1% decline in interest income from loans to Kshs 4.9 bn, from Kshs 5.5 bn in Q1’2018, which outweighed the 2.4% increase in interest income from government securities to Kshs 3.14 bn, from Kshs 3.07 bn in Q1’2018. The yield on interest-earning assets thus declined to 10.7%, from 11.3% in Q1’2018,
- Interest expenses declined by 3.0% to Kshs 3.6 bn, from Kshs 3.7 bn in Q1’2018, following an 8.9% decline in the interest expense on customer deposits to Kshs 3.0 bn, from Kshs 3.3 bn in Q1’2018, which outweighed the 14.1% rise in interest expense on placement liabilities to Kshs 225.0 mn, from Kshs 197.7 mn in Q1’2018, and the 78.0% increase in other interest expenses to Kshs 353.5 mn, from Kshs 198.6 mn in Q1’2018. The cost of funds thus declined to 5.0%, from 5.1% in Q1’2018. The Net Interest Margin (NIM) declined to 6.0%, from 6.4% in Q1’2018,
- Non-Funded Income (NFI) increased by 15.3% to Kshs 1.5 bn, from Kshs 1.3 bn in Q1’2018. The increase was mainly driven by a 75.8% rise in forex trading income to Kshs 0.6 bn, from Kshs 0.4 bn in Q1’2018 coupled with the 6.2% growth in other fee and commission income to Kshs 0.54 bn, from Kshs 0.51 bn in Q1’2018. The growth was however weighed down by the 26.1% decline in fees and commissions on loans to Kshs 0.3 bn, from Kshs 0.4 bn in Q1’2018. As a result of the performance, the revenue mix shifted to 75:25 from 79:21, due to the faster growth in NFI coupled with the decline in NII,
- Total operating expenses declined by 9.7% to Kshs 3.2 bn, from Kshs 3.5 bn, largely driven by the 61.5% decline in Loan Loss Provisions (LLP) to Kshs 0.3 bn in Q1’2019, from Kshs 0.7 bn in Q1’2018, which outweighed the 5.4% rise in staff costs to Kshs 1.1 bn in Q1’2019, from Kshs 1.0 bn in Q1’2018, and the 2.0% rise in other operating expenses to Kshs 1.80 bn, from Kshs 1.76 bn in Q1’2018,
- Due to the faster decline of total operating expenses compared to the total operating income, the Cost to Income Ratio (CIR) improved to 51.8%, from 56.3% in Q1’2018. However, without LLP, the cost to income ratio deteriorated to 47.4%, from 45.0% in Q1’2018, highlighting the decline in cost of risk to 4.4%, from 11.2% in Q1’2018, and,
- Profit before tax increased by 7.8% to Kshs 2.9 bn, up from Kshs 2.7 bn in Q1’2018. Profit after tax grew by 9.3% to Kshs 2.0 bn in Q1’2019, from Kshs 1.8 bn in Q1’2018 as the effective tax rate decreased to 33.1% from 33.7% in Q1’2018.

Balance Sheet

- The balance sheet recorded an expansion, albeit marginal, as total assets increased by 0.7% to Kshs 370.1 bn, from Kshs 367.7 bn in Q1’2018. This growth was largely driven by a 5.3% increase in investments in government and other securities to Kshs 125.7 bn, from Kshs 119.4 bn in Q1’2018, coupled with a 48.8%

increase in other assets to Kshs 12.9 bn, from Kshs 8.7 bn in Q1’2018, which outweighed the 2.9% decline in the loan book to Ksh 188.6 bn, from Kshs 194.1 bn in Q1’2018,

- Total liabilities declined by 1.1% to Kshs 309.3 bn, from Kshs 312.8 bn in Q1’2018, caused by a 31.6% decrease in borrowings to Kshs 12.5 bn, from Kshs 18.3 bn in Q1’2018, coupled with a 32.9% decline in placement liabilities to Kshs 12.8 bn, from Kshs 19.1 bn in Q1’2018, which outweighed the 1.3% increase in deposits to Kshs 275.3 bn, from Kshs 271.9 bn in Q1’2018. Deposits per branch increased by 3.5% to Kshs 2.0 bn, from Kshs 1.9 bn in Q1’2018, with the number of branches having reduced to 137 from 140 in Q1’2018,
- The decline in loans coupled with the increase in deposits led to a decline in the loan to deposit ratio to 68.5%, from 71.4% in Q1’2018,
- Gross Non-Performing Loans (NPLs) declined by 6.7% to Kshs 14.4 bn in Q1’2019 from Kshs 15.4 bn in Q1’2018. The NPL ratio thus improved to 7.3%, from 7.5% in Q1’2018. General Loan Loss Provisions declined by 36.5% to Kshs 5.3 bn, from Kshs 8.3 bn in Q1’2018, and consequently the NPL coverage declined to 50.7%, from 68.3% in Q1’2018,
- Shareholders’ funds increased by 11.6% to Kshs 55.4 bn in Q1’2019, from Kshs 49.7 bn in Q1’2018, as retained earnings grew by 16.6% y/y to Kshs 43.9 bn, from Kshs 37.6 bn in Q1’2018,
- Diamond Trust Bank Kenya is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 18.5%, 8.0% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 20.7%, exceeding the statutory requirement by 6.2% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 19.3%, while total capital to risk-weighted assets came in at 21.5%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.9%, and a Return on Average Equity (ROaE) of 13.0%.

Key Take-Outs:

1. The bank recorded a relatively weaker earnings performance with total operating income declining by 1.9%. This was largely due to the depressed performance of funded income, with the bank seemingly earning lower interest income owing to lower yields, presumably due to the 100 bps decline in the Central Bank Rate (CBR), and, the decline in yields on government securities, as the 5.3% growth in government securities investments resulted in a tepid 2.4% rise in interest income from the government securities investments. The expansion from the bottom line was largely due to a faster decline in total operating expenses, which was largely derived from the steep 61.5% decline in Loan Loss Provisions (LLP), and,

2. The bank recorded an improved performance on the NFI income segment, which recorded a 15.3%, growth y/y, largely supported by the 75.8% growth in forex trading income, and the 6.2% growth in other fee and commission income. Consequently, NFI contribution to total income rose to 25.3% from 21.5%. This however remains below the current industry average of 36.0%.

We expect the bank’s growth to be driven by:

1. **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,
2. **Operational Efficiency:** DTBK continues to be one of the most efficient banks, and as at Q1’2019, had a cost to income ratio of 51.8%, which was below the market average of 55.4%. Thus, DTBK’s continued focus on maintaining high operational margins coupled with an expanding bottom line will likely lead to consistent growth in the long run.

Below is a summary of the bank's performance:

Balance Sheet Items	Q1'2018	Q1'2019	y/y change	Q1'2019e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	119.4	125.7	5.3%	117.3	(1.8%)	7.1%
Net Loans and Advances	194.1	188.6	(2.9%)	198.0	2.0%	(4.9%)
Total Assets	**367.7**	**370.1**	**0.7%**	**383.9**	**4.4%**	**(3.8%)**
Customer Deposits	271.9	275.3	1.3%	287.1	5.6%	(4.3%)
Total Liabilities	312.8	309.3	(1.1%)	323.4	3.4%	(4.5%)
Shareholders' Funds	**49.7**	**55.4**	**11.6%**	**55.2**	**11.2%**	**0.4%**

Balance Sheet Ratios	Q1'2018	Q1'2019	y/y change
Loan to Deposit Ratio	71.4%	68.5%	(2.9%)
Return on average equity	15.1%	13.0%	(2.1%)
Return on average assets	2.0%	1.9%	(0.1%)

Income Statement	Q1'2018	Q1'2019	y/y change	Q1'2019e	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	4.9	4.5	(6.6%)	5.0	3.5%	(10.2%)
Net non-Interest Income	1.3	1.5	15.3%	1.5	15.1%	0.2%
Total Operating income	**6.2**	**6.1**	**(1.9%)**	**6.6**	**6.0%**	**(7.9%)**
Loan Loss provision	0.7	0.3	(61.5%)	0.8	10.5%	(71.9%)
Total Operating expenses	3.5	3.2	(9.7%)	3.7	5.9%	(15.6%)
Profit before tax	**2.7**	**2.9**	**7.8%**	**2.9**	**7.0%**	**0.8%**
Profit after tax	**1.8**	**2.0**	**9.3%**	**2.0**	**9.7%**	**(0.4%)**

Income Statement Ratios	Q1'2018	Q1'2019	y/y change
Yield from interest-earning assets	11.3%	10.7%	(0.6%)
Cost of funding	5.1%	5.0%	(0.2%)
Net Interest Spread	6.2%	5.7%	(0.5%)
Net Interest Income as % of operating income	78.5%	74.7%	(3.8%)
Non-Funded Income as a % of operating income	21.5%	25.3%	3.8%
Cost to Income Ratio (CIR)	56.3%	51.8%	(4.4%)
CIR without provisions	45.0%	47.4%	2.4%
Cost to Assets	4.3%	3.8%	(0.5%)
Net Interest Margin	6.4%	6.0%	(0.4%)

Capital Adequacy Ratios	Q1'2018	Q1'2019
Core Capital/Total Liabilities	18.2%	20.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**10.2%**	**12.3%**
Core Capital/Total Risk Weighted Assets	17.5%	18.5%
Minimum Statutory ratio	10.5%	10.5%
Excess	**7.0%**	**8.0%**

Total Capital/Total Risk Weighted Assets	19.1%	20.7%
Minimum Statutory ratio	14.5%	14.5%
Excess	**4.6%**	**6.2%**
Liquidity Ratio	51.5%	53.4%
Minimum Statutory ratio	20.0%	20.0%
Excess	**31.5%**	**33.4%**