Diamond Trust Bank Kenya Earnings Update – Q3'2016

20th November, 2016

Valuation Summary

- We recommend a SELL for the DTB stock with a target price of Kshs 116.0 representing a downside of 10.9%, from the current price of Kshs 133.0, as at 17th November, 2016 inclusive of a dividend yield of 1.9%
- DTB is currently trading at a P/B of 0.9x and a P/E of 6.7x, vs an industry average of 0.9x and 5.2x, respectively.

Key highlights during Q3'2016

- DTB opened 3 new branches across the country in Narok, Milele Mall in Ngong' town and Watamu in August and September that will provide all DTB banking and credit services
- DTB partnered with Postal Corporation of Kenya (PCK) to boost its agency banking to a network of 1,000 agents from the current 600, through PCK's extensive network of around 470 post offices across the country.

Income Statement

- Core earnings per share grew by 11.4% to Kshs 20.0 from Kshs 17.9 in Q3'2015 driven by a 29.2% growth in total operating revenue despite a 44.4% increase in total operating expenses
- Total operating revenue grew by 29.2% to Kshs 18.4 bn from Kshs 14.2 bn in Q3'2015, slower than our estimate of an 33.8% growth. This was supported by a 35.2% Net Interest Income (NII) growth and a 9.8% growth Non-Funded Income
- Interest Income grew by 38.7% to Kshs 25.5 bn from Kshs 18.4 bn in Q3'2015, outpaced by the 43.7% growth in Interest expense to Kshs 10.8 bn from Kshs 7.5 bn in Q3'2015. Despite a faster growth in Interest expense, Net Interest Margin improved slightly to 6.8% from 6.6% in Q3'2015
- Non-Funded Income (NFI) grew by 9.8% to Kshs 3.7 bn, from Kshs 3.4 bn in Q3'2015, below our expectation of a 27.2% increase. The increase in NFI was supported by a 15.3% growth in other fees and commissions to Kshs 1.5 bn from Kshs 1.3 bn in Q3'2015 and a 7.1% growth in fees and commissions from loans to Kshs 0.8 bn from Kshs 0.7 bn in Q3'2015. The current revenue mix stands at 80:20, Funded to Non-Funded Income from 76:24 in Q3'2015
- Total operating expenses grew by 44.4% to Kshs 10.6 bn from Kshs 7.3 bn in Q3'2015 driven by a 171.9% rise in Loan Loss Provision (LLP) to Kshs 3.6 bn from Kshs 1.3 bn in Q3'2015 and a 15.1% y/y growth in staff costs to Kshs 2.8 bn from Kshs 2.4 bn. Without LLP, operating expenses grew by 16.3% to Ksh 7.0 bn from Kshs 6.0 bn in Q3'2015
- The faster growth in operating expenses compared to operating revenue resulted in the cost to income ratio increasing to 57.6% from 51.5% in Q3'2015. Excluding LLP, cost to income ratio stood at 38.0% from 42.2% in the same period last year
- Profit after tax increased by 11.4% to Kshs 5.3 bn from Kshs 4.8 bn in Q3'2015.

Balance Sheet

- The balance sheet recorded an increase in Q3'2016, with total assets increasing by 28.4% to Kshs 313.8 bn from Kshs 244.4 bn in Q3'2015, driven by a 185.4% growth in allocation to government securities which stood at Kshs 92.2 bn from Kshs 32.3 bn
- The loan book recorded a 5.4% growth to Kshs 181.6 bn from Kshs 172.3 bn in Q3'2015, in line with our expectation of a 5.5% increase
- Total liabilities increased by 30.0% to Kshs 271.2 bn from Kshs 208.6 bn in Q3'2015 compared to our projections of a 26.5% increase, driven by a 254.2% rise in placements by other banks to Kshs 16.4 bn from Kshs 4.6 bn in Q3'2015. Shareholder funds increased by 17.3% to Kshs 37.8 bn
- In line with our estimates of a 25.6% growth, customer deposits grew by 29.9% to Kshs 227.4 bn from Kshs 175.1 bn in Q3'2015 benefiting from the continued flight to safety by depositors from smaller banks. The faster growth in customer deposits resulted in the loan to deposit ratio declining to 79.8% from 98.4% in Q3'2015
- Gross non-performing loans grew by 182.3% to Kshs 7.8 bn from Kshs 2.7 bn in Q3'2016 which led to an increase in the NPL ratio to 4.1% from 1.6% in Q3'2015
- The yield on interest earning assets increased to 10.2% from 9.8% in Q3'2015, while cost of funds increased to 4.6% from 4.2% in Q3'2015
- DTB currently operates at a Return on average Assets (ROaA) and Return on average Equity (ROaE) of 2.6% and 20.4%, down from 2.8% and 20.6% in Q3'2015, respectively

- DTB is currently sufficiently capitalized with core capital to risk weighted assets ratio at 14.9%, 4.4% above the statutory requirement, with the total capital to total risk weighted assets exceeding statutory requirement by 2.8%.

Key Take Outs:

a) DTB posted good growth in earnings, in line with our expectations supported by their strong growth in interest income, the largest increase coming from interest earned from government securities which grew at 131.2% to Kshs 6.9 bn from Kshs 3.0 bn in Q3’2015
b) Loan loss provision continues to remain high for DTB as it is for the industry, thus resulting in a cut-back on earnings growth for the bank.

Moving forward, DTB will thrive on:

i. The uptake of DTB products and services through alternative channels such as digital banking, agency and intelligent ATMs that are convenient and easy to use promoting deposit mobilisation
ii. Revenue diversification with new business lines such as bancassurance through Life Insurance by DTB
iii. Regional business expansion and further exploration of alternative channels remain the two main areas we expect DTB to leverage on for future growth.

Below is a summary of the key line items in the balance sheet and income statement

Figures in Kshs billions unless otherwise stated

Balance Sheet Items	FY'2015	Q3'2015	Q3'2016	y/y change	Q3'2016e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	47.1	32.3	92.2	185.4%	58.4	80.8%	104.5%
Net Loans and Advances	177.5	172.3	181.6	5.4%	181.7	5.5%	(0.1%)
Total Assets	**271.6**	**244.4**	**313.8**	**28.4%**	**306.8**	**25.6%**	**2.9%**
Customer Deposits	194.1	175.1	227.4	29.9%	226.9	29.6%	0.3%
Total Liabilities	233.3	208.6	271.2	30.0%	263.9	26.5%	3.5%
Shareholders’ Funds	**34.1**	**32.2**	**37.8**	**17.3%**	**38.3**	**18.9%**	**(1.6%)**

Balance Sheet Ratios	Q3'2015	Q3'2016	y/y change
Loan to Deposit Ratio	98.4%	79.8%	(18.6%)
Return on average equity	20.6%	20.4%	(0.2%)
Return on average assets	2.8%	2.6%	(0.3%)

Income Statement	FY'2015	Q3'2015	Q3'2016	y/y change	Q3'2016e	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	15.2	10.9	14.7	35.2%	14.8	35.9%	(0.7%)
Net non-Interest Income	4.7	3.4	3.7	9.8%	4.3	27.2%	(17.4%)
Total Operating income	**19.9**	**14.2**	**18.4**	**29.2%**	**19.1**	**33.8%**	**(4.6%)**
Loan Loss provision	2.2	1.3	3.6	171.9%	2.7	104.0%	67.9%
Total Operating expenses	**10.3**	**7.3**	**10.6**	**44.4%**	**11.1**	**50.9%**	**(6.5%)**
Profit before tax	9.6	6.9	7.8	13.0%	8.0	15.7%	(2.7%)
Profit after tax	**6.6**	**4.8**	**5.3**	**11.4%**	**5.6**	**17.3%**	(5.9%)

Income Statement Ratios	Q3'2015	Q3'2016	y/y change
Yield from interest-earning assets	9.8%	10.2%	0.4%
Cost of funding	4.2%	4.6%	0.4%
Net Interest Spread	5.6%	5.6%	0.0%
Net Interest Margin	6.6%	6.8%	0.2%
Cost of Risk	19.6%	9.3%	10.3%
Net Interest Income as % of operating income	76.3%	79.8%	3.6%
Non-Funded Income as a % of operating income	23.7%	20.2%	(3.6%)

Cost to Income Ratio	51.5%	57.6%	6.1%
Cost to Assets	2.8%	2.5%	(0.2%)

Capital Adequacy Ratios	Q3'2015	Q3'2016
Core Capital/Total Liabilities	22.0%	16.5%
Minimum Statutory ratio	8.0%	8.0%
Excess	**14.0%**	**8.5%**
Core Capital/Total Risk Weighted Assets	14.4%	14.9%
Minimum Statutory ratio	10.5%	10.5%
Excess	**3.9%**	**4.4%**
Total Capital/Total Risk Weighted Assets	17.5%	17.3%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.0%**	**2.8%**
Liquidity Ratio	30.0%	48.5%
Minimum Statutory ratio	20.0%	20.0%
Excess	**10.0%**	**28.5%**