Diamond Trust Bank Kenya Earnings Update – H1'2017

27th August, 2017

Valuation Summary

- We recommend a "BUY" for the DTB stock with a target price of Kshs 241.1 representing an upside of 28.3%, from the current price of Kshs 190.0, as at 25th August, 2017, inclusive of a dividend yield of 1.4%
- DTB is currently trading at a tangible P/B of 1.3x and a P/E of 7.1x, vs an industry average of 1.5x and 7.9x, respectively.

Key highlights during H1'2017

- DTB completed the acquisition of Habib Bank Limited Kenya branches in a share swap transaction that involved issuance of 13.3 mn new shares at a price of Kshs 137.4 per share in July 2017, increasing Habib's shareholding in DTB to 16.2% from 12.0%, previously. The Aga Khan Fund for Economic Development remains the top shareholder at 16.5% shareholding, down from 17.3% previously,
- The bank opened its second branch in Eldoret as part of its regional expansion strategy, mainly targeting SMEs in the agricultural town.

Income Statement

- Core earnings per share decreased by 5.8% to Kshs 12.2 from Kshs 13.0 in H1'2016, driven by a 2.6% increase in total operating expenses and a 0.4% decline in total operating revenue,
- Total operating revenue declined marginally by 0.4% to Kshs 12.0 bn from Kshs 12.1 bn in H1'2016, against our estimate of a 3.1% growth. This was supported by a 0.8% decline in Net Interest Income despite the 1.2% growth in Non-Funded income,
- Net Interest Income decreased by 0.8% as a result of a 2.7% increase in interest expense to Kshs 7.4 bn from Kshs 7.2 bn in H1'2016,which outpaced a 0.7% growth in Interest Income to Kshs 16.9 bn from Kshs 16.7 bn in H1'2016, leading to a decline in Net Interest Margin to 6.8% from 7.6%,
- Non-Funded Income (NFI) increased by 1.2% to Kshs 2.54 bn from Kshs 2.51 bn in H1'2016. The increase in NFI was driven by an 18.1% increase in fees and commissions on loans and advances to Kshs 0.6 bn from Kshs 0.5 bn in H1'2016. The current revenue mix remained unchanged at 79:21 funded to non-funded income,
- Total operating expenses increased by 2.6% to Kshs 7.0 bn from Kshs 6.8 bn in H1'2016, following a 20.8% y/y increase in rental charges to Kshs 0.4 bn from Kshs 0.3 bn. Loan Loss Provision (LLP) declined by 21.7% to Kshs 1.7 bn from Kshs 2.2 bn in H1'2016. Without LLP, operating expenses grew 14.0% to Kshs 5.3 bn from Kshs 4.6 bn registered in H1'2016. Staff costs grew by 13.2% to Kshs 2.0 bn from Kshs 1.8 bn in H1'2016,
- Cost to Income ratio worsened to 58.1% from 56.5% in H1'2016. Without LLP, Cost to Income ratio deteriorated to 43.9% from 38.3% in H1'2016,
- Profit before tax decreased by 4.1% to Kshs 5.0 bn from Kshs 5.3 bn while Profit after tax decreased by 5.8% to Kshs 3.4 bn from Kshs 3.6 bn in H1'2016
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Balance Sheet

- The balance sheet recorded an expansion in H1'2017, with total assets increasing by 13.8% to Kshs 343.7 bn from Kshs 301.9 bn in H1'2016, driven by a rise in holdings of government securities of 34.1% to Kshs 105.4 bn from Kshs 78.6 bn,
- The loan book grew by 7.2% to Kshs 191.5 bn from Kshs 178.5 bn in H1'2016, in line with our expectations of an 8.7% growth,
- Total liabilities increased by 13.1% to Kshs 295.2 bn from Kshs 261.0 bn in H1'2016, while shareholders' funds increased by 19.7% to Kshs 43.5 bn from Kshs 36.3 bn,
- Customer deposits grew by 18.6% to Kshs 256.3 bn from Kshs 216.1 bn in H1'2016, due to the bank's efforts to strengthen its network through opening up an additional branches in Eldoret during H1'2017, partnering with the Postal Corporation of Kenya (PCK) to increase its agency network, and it's gain from Imperial Bank Ltd (IR) clients, whereby Imperial Bank depositors were allowed access to their funds under the management of DTB and KCB Group,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 74.7% from 82.6% in H1'2016,
- Gross non-performing loans increased by 24.7% to Kshs 9.2 bn from Kshs 7.4 bn in H1'2016, which led to a

deterioration in the NPL ratio to 4.6% from 4.0% in H1’2016,

- The yield on interest earning assets decreased to 12.0% from 13.2% in H1’2016, while the cost of funds also decreased to 5.3% from 5.7%,
- DTB Kenya is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 16.0%, 5.5% above the statutory requirement of 10.5%, with total capital to total risk weighted assets exceeding statutory requirement by 3.5% to close the period at 18.0%,
- DTB currently has a return on average assets of 2.3% and a return on average equity of 18.8%.

Key Take Outs:

a) From these results, we have noted that: (i) the NPL ratio has hit a 5 year high of 4.6%, (ii) NIM’s have declined to a 5-year low of 6.8%, and (iii) ROaE has declined to 18.8% from a 5 year average of 24.9%,
b) Despite these, (i) DTB continues to grow deposits at double digit figures, currently at an 18.6% y/y growth, in line with our projections of an 18.7%, and (ii) the bank’s balance sheet continues to grow with total assets increasing by 13.8% to Kshs 343.7 bn, affirming the bank’s status as a Tier I bank,
c) DTB performed below our expectations after having exceeded our expectations previously (i) in FY’2016 when they posted positive EPS growth of 16.6%, above the listed industry average (market weighted) of 4.4%, and (ii) in Q1’2017 when they recorded positive EPS growth of 8.8%, still above the listed industry average (market weighted) of (8.6%).

Moving forward, DTB will thrive on:

a) Focusing on maintaining their asset quality by reducing their non-performing loans through improved credit risk management and loan recovery efforts,
b) Increased efficiency through cutting down of costs by opening more digital branches offering 24/7 customer service similar to those already at The Oval, Westlands and Garden City, hence cutting staff costs, increasing working hours and still providing all banking services,
c) Increasing exposure to government securities as they have done throughout 2017, as growth of their loan book continues to slow down due to the Law on Loan pricing given that DTB is largely an SME bank,
d) Leveraging on new and innovative products such as bancassurance through Diamond Trust Insurance Agency Ltd and increased card partnerships like those with Nakumatt, NationHela and MI-Card; in a bid to increase non-funded income which grew just 1.2% compared to Q1’2017 growth of 8.3% y/y.

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	H1'2016	H1'2017	y/y change	H1'2017e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	78.6	105.4	34.1%	94.1	19.7%	14.4%
Net Loans and Advances	178.5	191.5	7.2%	194.0	8.7%	(1.4%)
Total Assets	**301.9**	**343.7**	**13.8%**	**350.4**	**16.1%**	**(2.2%)**
Customer Deposits	216.1	256.3	18.6%	256.5	18.7%	(0.1%)
Total Liabilities	261.0	295.2	13.1%	300.8	15.2%	(2.2%)
Shareholders’ Funds	**36.3**	**43.5**	**19.7%**	**44.7**	**22.9%**	**(3.2%)**

Balance Sheet Ratios	H1'2016	H1'2017	y/y change
Loan to Deposit Ratio	82.6%	74.7%	(7.9%)
Return on average equity	20.7%	18.8%	(1.9%)
Return on average assets	2.6%	2.3%	(0.3%)

Income Statement	H1'2016	H1'2017	y/y change	H1'2017e	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	9.6	9.5	(0.8%)	9.9	3.8%	(4.6%)

Net non-Interest Income	2.5	2.5	1.2%	2.5	0.3%	0.9%
Total Operating income	12.1	12.0	(0.4%)	12.5	3.1%	(3.5%)
Loan Loss provision	2.2	1.7	(21.7%)	1.5	(29.8%)	8.2%
Total Operating expenses	6.8	7.0	2.6%	6.9	1.8%	0.7%
Profit before tax	5.3	5.0	(4.1%)	5.5	4.8%	(8.9%)
Profit after tax	**3.6**	**3.4**	**(5.8%)**	**3.9**	**6.5%**	(12.3%)

Income Statement Ratios	H1'2016	H1'2017	y/y change
Yield from interest-earning assets	7.1%	6.0%	(1.2%)
Cost of funding	3.2%	2.7%	(0.5%)
Net Interest Spread	4.0%	3.3%	(0.7%)
Net Interest Income as % of operating income	79.2%	78.9%	(0.3%)
Non-Funded Income as a % of operating income	20.8%	21.1%	0.3%
Cost to Income Ratio (CIR)	56.5%	58.1%	1.7%
CIR without provisions	38.3%	43.9%	5.5%
Cost to Assets	3.3%	3.0%	(0.3%)
Net Interest Margin	7.6%	6.8%	(0.8%)

Capital Adequacy Ratios	H1'2016	H1'2017
Core Capital/Total Liabilities	17.1%	16.8%
Minimum Statutory ratio	8.0%	8.0%
Excess	**9.1%**	**8.8%**
Core Capital/Total Risk Weighted Assets	14.7%	16.0%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.2%**	**5.5%**
Total Capital/Total Risk Weighted Assets	17.1%	18.0%
Minimum Statutory ratio	14.5%	14.5%
Excess	**2.6%**	**3.5%**
Liquidity Ratio	47.8%	51.3%
Minimum Statutory ratio	20.0%	20.0%
Excess	**27.8%**	**31.3%**