Diamond Trust Bank Kenya – FY’2019

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Valuation Summary

- We are of the view that Diamond Trust Bank Kenya is a “***buy***” with a target price of Kshs 189.0, representing an upside of 110.0%, from the current price of Kshs 90.0 as of 20th March 2020, inclusive of a dividend yield of 2.9%,
- Diamond Trust Bank Kenya is currently trading at a P/TBV of 0.4x and a P/E of 3.5x vs an industry average of 1.1 x and 5.9x, respectively.

Key Highlights FY’2019

- DTBK partnered with the Simba Corporation to enable Small and Medium Enterprises category to acquire new Fuso trucks. The vehicles will be made available with 100 percent financing under the bank’s motor vehicle financing scheme dubbed ‘Beba Leo’. The partnership was aimed at cementing the bank’s commitment to growing the SME sector’

Income Statement

- Diamond Trust Bank Kenya released their FY’2019 financial results, with core earnings per share increasing by 1.6% to Kshs 24.3, from Kshs 23.9 in FY’2018, slower than our expectation of a 3.7% increase to Kshs 24.8 per share. The performance was driven by an 8.7% decline in total operating expenses, which mitigated the 3.8% decline in total operating income. The variance in core earnings per share growth against our expectations was largely due to the slower 8.7% decline in total operating expense, against our 12.3% expectations,
- Total operating income declined by 3.8% to Kshs 24.5 bn from Kshs 25.5 bn in FY’2018. This was due to a 6.5% decline in Net Interest Income (NII) to Kshs 18.7 bn, from Kshs 20.0 bn in FY’2018, offsetting the 6.2% increase in Non-Funded Income (NFI) to Kshs 5.8 bn, from Kshs 5.4 bn in FY’2018,
- Interest income declined by 6.9% to Kshs 32.9 bn from Kshs 35.3 bn in FY’2018. This was driven by a 9.1% decline in interest income from loans and advances to Kshs 20.0 bn, from Kshs 22.0 bn in FY’2018, coupled with a 3.9% decline in interest income from government securities to Kshs 12.5 bn from Kshs 13.0 bn in FY’2018. The interest income from deposit placements however increased by 32.2% to Kshs 0.4 bn from Kshs 0.3 bn in FY’2018. The yield on interest-earning assets declined to 9.9% from 10.9% in FY’2018, largely attributable to a decline in yields on government securities as well as a decline in lending rates, which saw interest income decline by 6.9%, coupled up with by the 2.6% decline recorded in the average interest-earning assets,
- Interest expenses declined by 7.3% to Kshs 14.1 bn from Kshs 15.3 bn in FY’2018, following a 9.9% decline in interest expense on customer deposits to Kshs 12.1 bn from Kshs 13.5 bn in FY’2018, coupled with a 20.0% decline in interest expense on placement liabilities to Kshs 0.6 bn from Kshs 0.8 bn in FY’2018. Cost of funds, however, declined to 4.5% from 4.9% in FY’2018, owing to the faster 7.3% decline in interest expenses that outpaced the 0.2% decline in interest-bearing liabilities to Kshs 314.0 bn from Kshs 314.7 bn in FY’2018. Net Interest Margin (NIM) declined to 5.6%, from 6.2% in FY’2017 due to a 6.5% decline in NII coupled up with a 2.6%

decline in average interest-earning assets,

- Non-Funded Income (NFI) rose by 6.2% to Kshs 5.8 bn, from Kshs 5.4 bn in FY'2018. The increase was mainly driven by the 4.3% increase in fees and commissions to Kshs 1.34 bn from Kshs 1.28 in FY'2018 coupled up 16.5% growth in the forex trading income to Kshs 1.8 bn from Kshs 1.6 bn in FY'2018. The growth in NFI was however weighed down by the 7.2% decline in other non-interest income, to Kshs 0.39 bn from Kshs 0.42 in FY'2018. As a result, the revenue mix shifted to 76:24 from 79:21 funded to non-funded income, owing to the faster growth in NFI as compared to the decline in NII,
- Total operating expenses declined by 8.7% to Kshs 13.2 bn from Kshs 14.9 bn in FY'2018, largely driven by the 55.6% decline in Loan Loss Provisions (LLP) to Kshs 1.3 bn from Kshs 3.0 bn in FY'2018 and, staff costs, which rose by 11.4%, to Kshs 4.7 bn from Kshs 4.2 bn in FY'2018. However, this was offset by other operating expenses which declined by 1.1% to Kshs 7.2 bn from Kshs 7.3 bn in FY'2018,
- The Cost to Income Ratio (CIR) improved to 54.0 %, from 56.9% in FY'2018. However, without LLP, the cost to income ratio deteriorated to 48.6%, from 45.2% in FY'2018, highlighting a decline in the levels of efficiency,
- Profit before tax rose by 2.4% to Kshs 11.3 bn, from Kshs 11.0 bn in FY'2018. Profit after tax grew by 2.7% to Kshs 7.3 bn in FY'2019, from Kshs 7.1 bn in FY'2018, with the effective tax rate declining marginally to 35.5% from 35.6% in FY'2018, and,
- The bank recommends a first and final dividend of Kshs 2.7 per share, which is a 3.8% rise from Kshs 2.6 per share paid in FY'2018. This translates to a dividend yield of 2.9% at the current price of Kshs 90.0, and a payout ratio of 10.4%.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 2.3% to Kshs 386.2 bn from Kshs 377.7 bn in FY'2018. This growth was largely driven by a 12.9% increase in government securities to Kshs 132.5 bn from Kshs 117.3 bn in FY'2018, coupled with a 45.3% increase in other assets to Kshs 13.1 bn from Kshs 9.0 bn in FY'2018. The loan book on the other hand expanded by 3.1% to Kshs 199.1 bn from Kshs 193.1 bn in FY'2018. The growth in assets was however slowed down by a 41.2% decrease in placements to Kshs 8.3 bn from Kshs 14.2 bn in FY'2018,
- Total liabilities rose by 0.9% to Kshs 321.7 bn from Kshs 318.8 bn in FY'2018, driven by a 31.0% increase in placement liabilities to Kshs 22.5 bn from Kshs 17.1 bn in FY'2018, coupled with the 89.0% increase in other liabilities to Kshs 7.7 bn from Kshs 4.1 bn in FY'2018. The growth was however mitigated by the 22.7% decline in borrowings to Kshs 11.4 bn from Kshs 14.7 bn in FY'2018, coupled with the 0.9% decline in customer deposits to Kshs 280.2 bn from Kshs 282.9 bn in FY'2018. Deposits per branch declined by 0.9% to Kshs 2.05 bn from Kshs 2.06 bn in FY'2018, as the number of branches remaining unchanged at 137 in FY'2019,
- Loans to deposit ratio increased to 71.1% from 68.3% in FY'2018, owing to the growth in net loans, coupled with declining customer deposits during the period,
- Gross Non-Performing Loans (NPLs) rose by 16.9% to Kshs 15.9 bn in FY'2019 from Kshs 13.6 bn in FY'2018. Consequently, the NPL ratio deteriorated to 7.6% in FY'2019 from 6.8% in FY'2018. General Loan Loss Provisions increased by 67.6% to Kshs 9.1 bn from Kshs 5.4 bn in FY'2018. Consequently, the NPL coverage increased to 71.6% in FY'2019 from 50.6% in FY'2018,
- Shareholders' funds increased by 9.7% to Kshs 58.9 bn in FY'2019 from Kshs 53.7 bn in FY'2018, largely due to the 12.9 % increase in the retained earnings to Kshs 47.5 bn, from Kshs 42.1 bn in FY'2018,
- Diamond Trust Bank is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 19.1%, 8.6% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 20.9%, exceeding the 14.5% statutory requirement by 6.4% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 19.9%, while total capital to

risk-weighted assets came in at 21.8%, and,

- The bank currently has a Return on Average Assets (ROaA) of 1.9%, and a Return on Average Equity (ROaE) of 12.9%.

Key Take-Outs:

1. The bank's asset quality deteriorated, with the NPL ratio increasing to 7.6% from 6.7% in FY'2018. The decline in asset quality is attributable to a 16.9% increase in the gross NPLs to Kshs 15.9 bn in FY'2019 from Kshs 13.6 bn in FY'2018,
2. The bank recorded an improved performance on the NFI income segment, which recorded a 6.2% growth y/y, largely supported by the 16.5% increase in forex trading income, coupled with a 4.3% increase in fees and commissions. Consequently, NFI contribution to total income rose to 23.6% from 21.3% in FY'2018. This, however, remains below the current industry average of 38.0%, and,
3. There was a decline in efficiency levels as the cost to income ratio without LLP worsened to 48.6% from 45.2% in FY'2018. The deterioration was largely attributable to an 11.4% rise in staff cost, which depressed the bottom line.

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

I. Geographical diversification - The bank's forays into other markets such as Tanzania, Uganda, and Burundi, may aid the bank's growth, given the lack of loan pricing controls in those markets. Continued focus on those markets would aid in alleviating the compressed interest income regime in the Kenyan market.

Below is a summary of the bank's performance:

Balance Sheet Items	FY'2018	FY'2019	y/y change	FY'2019e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	117.3	132.5	12.9%	112.0	(4.5%)	17.4%
Net Loans and Advances	193.1	199.1	3.1%	203.7	5.5%	(2.4%)
Total Assets	**377.7**	**386.2**	**2.3%**	**399.0**	**5.6%**	**(3.4%)**
Customer Deposits	282.9	280.2	(0.9%)	291.0	2.9%	(3.8%)
Total Liabilities	318.8	321.7	0.9%	327.5	2.7%	(1.8%)
Shareholders' Funds	**53.7**	**58.9**	**9.7%**	**65.7**	**22.4%**	**(12.8%)**

Balance Sheet Ratios	FY'2018	FY'2019	y/y change
Loan to Deposit Ratio	68.3%	71.1%	2.8%
Return on average equity	13.9%	12.9%	(1.0%)
Return on average assets	1.9%	1.9%	(0.0%)

Income Statement	FY'2018	FY'2019	y/y change	FY'2019e	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	20.0	18.7	(6.5%)	18.5	(7.5%)	0.9%
Net non-Interest Income	5.4	5.8	6.2%	5.9	8.1%	(1.9%)
Total Operating income	**25.46**	**24.48**	**(3.8%)**	**24.40**	**(4.2%)**	**0.3%**
Loan Loss provision	3.0	1.3	(55.6%)	1.4	(51.9%)	(3.7%)

Income Statement	FY'2018	FY'2019	y/y change	FY'2019e	Projected %y/y change	Variance in Growth Actual vs. Expected
Total Operating expenses	14.5	13.2	(8.7%)	12.7	(12.3%)	3.5%
Profit before tax	**11.0**	**11.3**	**2.4%**	**11.7**	**6.4%**	**(4.0%)**
Profit after tax	**7.1**	**7.3**	**2.7%**	**8.0**	**12.4%**	**(9.7%)**

Income Statement Ratios	FY'2018	FY'2019	y/y change
Yield from interest-earning assets	10.9%	9.9%	(1.0%)
Cost of funding	4.9%	4.5%	(0.4%)
Net Interest Spread	6.0%	5.4%	(0.6%)
Net Interest Income as % of operating income	78.7%	76.4%	(2.2%)
Non-Funded Income as a % of operating income	21.3%	23.6%	2.2%
Cost to Income Ratio (CIR)	56.9%	54.0%	(2.9%)
CIR without provisions	45.2%	48.6%	3.4%
Cost to Assets	3.9%	3.5%	(0.4%)
Net Interest Margin	6.2%	5.6%	(0.6%)

Capital Adequacy Ratios	FY'2018	FY'2019
Core Capital/Total Liabilities	19.4%	22.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**11.4%**	**14.3%**
Core Capital/Total Risk Weighted Assets	18.7%	19.1%
Minimum Statutory ratio	10.5%	10.5%
Excess	**8.2%**	**8.6%**
Total Capital/Total Risk Weighted Assets	21.1%	20.9%
Minimum Statutory ratio	14.5%	14.5%
Excess	**6.6%**	**6.4%**
Liquidity Ratio	53.5%	54.8%
Minimum Statutory ratio	20.0%	20.0%
Excess	**33.5%**	**34.8%**