KESTREL CAPITAL
Member of the Nairobi Securities Exchange

July 2014

Diamond Trust Bank– Rights Issue Report
"DIAMONDS ARE FOREVER"
Recommendation: BUY

We issue a **Buy** recommendation on Diamond Trust Bank (DTB) based on a 1 year target price of KES 264.00, representing 60.0% upside from the Rights Issue price of KES 165.00. Our positive sentiments are supported by sound balance sheet growth (3 year CAGR of 22.0% to FY16F), driven by sturdy loan book and customer deposit growth (3 year CAGR) of 22.7% and 21.4% to FY16F respectively. We expect sustained cost management measures to drive stability in the cost-to-income ratio going forward, with a 3 year CTI average of 40.7% to FY16F. We expect this to translate to +12.0% y/y growth in EPS to KES 24.20 in FY14, owing to dilution from the Rights Issue. (+23.2% y/y EPS growth in FY14F, like for like comparison)

Positives

- Net Interest Income to be driven by stable NIMs and strong loan book growth in FY14F: We forecast a 3 year CAGR of 25.3% in Net Interest Income to FY16F, propelled by 3 year CAGR of 20.7% in Interest Income to FY16F
- Core liability growth to continue keeping pace with asset growth going forward: We expect DTB to grow its loan book and deposits at 23.0% y/y and 23.6% y/y in FY14F
- Superior loan book quality to be maintained on the back of prudent credit risk policies: A historical 3 year NPL ratio average of 1.2% and a coverage ratio of 98.4% to FY13
- Non-interest income increase driven by fees and commission income growth: We expect DTB's non funded income to record a forward 3 year CAGR of 10.5% to FY16F
- Focus on alternative channels of expansion over conservative brick and mortar branch expansion to maintain low CTI going forward: DTB aims to increase the regional number of branches from 101 to 110 branches by December 2014
- Rights Issue proceeds to grow DTB's investment in subsidiaries and its asset base in Kenya: DTB is seeking to raise KES 3.6bn (USD 41.7m) by way of Rights Issue

Negatives

- Low dividend yield expected going forward: DTB's dividend yield stands at 0.9%, against a sector average of 3.4%

Performance of DTB against 4 East African banking sectors: DTB Group has recorded a 3 year CAGR in loans and deposits of 29.4% and 24.8% respectively to FY13, outgrowing the loan book and deposit growth of the 4 countries. The cumulative loan book and deposits growth of the 4 banking sectors recorded a 3 year CAGR in loans and deposits of 17.4% and 14.8% respectively to FY13

	FY13	FY14F	FY15F	FY16F
EPS (KES)	21.61	24.20	30.43	37.65
Growth %	23.6	12.0	25.7	23.8
DPS (KES)	2.10	2.20	2.40	2.60
Growth %	10.5	4.8	9.1	8.3
P/E ratio (x)	11.2	10.0	7.9	6.4
PEG ratio (x)	0.5	0.8	0.3	0.3
P/B ratio (x)	2.5	1.9	1.6	1.3
Dividend Yield %	0.9	0.9	1.0	1.1
ROaE %	25.4	23.0	22.0	22.1

Source: Company, Kestrel Capital estimates

Bloomberg Ticker :	**DTKL. KN**
Reuters Ticker:	**DTKL.NR**

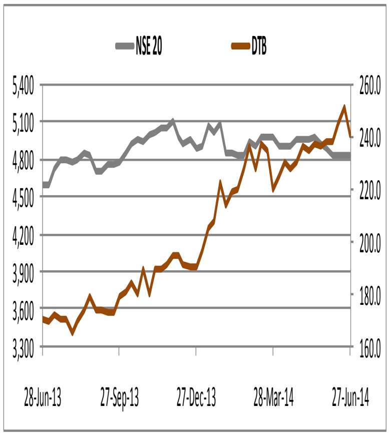
Share Statistics

Fair Value (KES)	226.00
Current Price (KES)	240.00
Current Issued shares (m)	220.1
Post Rights Issued shares (m)	242.1
Current market cap (KES bn)	53.0
Current market cap (USD m)	605.2
Year end	Dec
Free Float (%)	49.1
Avg daily trading vol (USD)	508,806.0

Price Return

	Absolute	Excess
3 month	9.5%	12.3%
6 month	26.8%	27.9%
12 month	34.6%	33.3%

Price Trend



Source: Nairobi Securities Exchange

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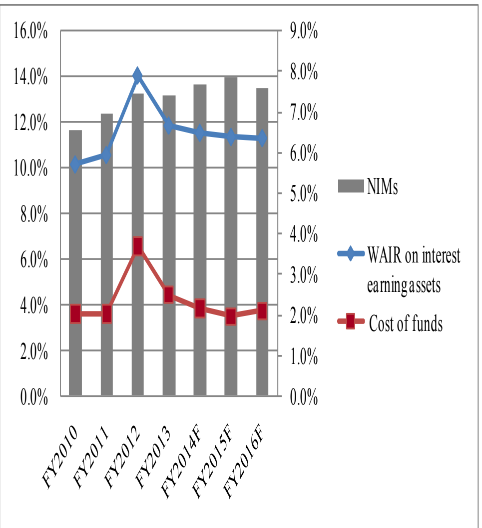
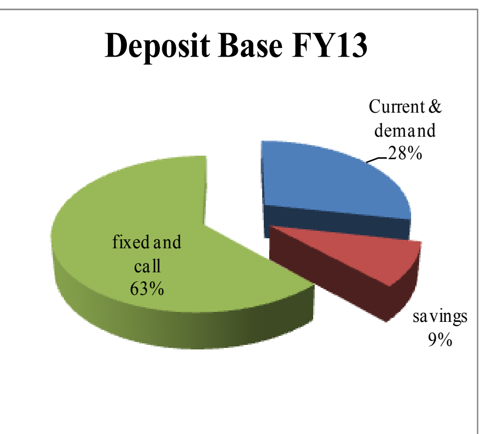
Positives



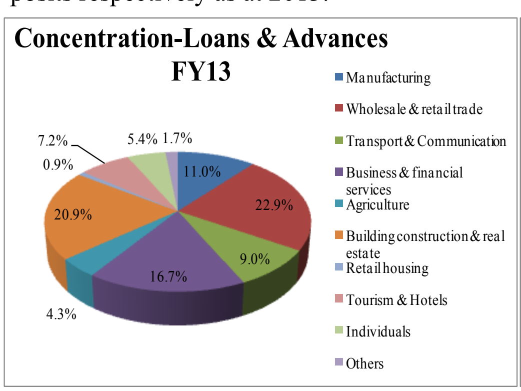
Source: Kestrel Research

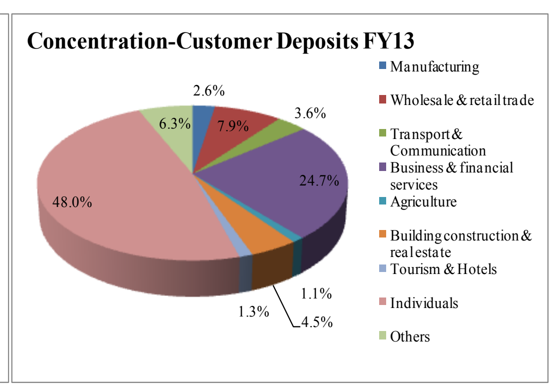
Net Interest Income to be driven by stable NIMs and strong loan book growth in FY14F: We forecast a 3 year CAGR of 25.3% in Net Interest Income to FY16F, propelled by 3 year CAGR of 20.7% in Interest Income to FY16F. We expect interest expenses to grow at a slower rate of 3 year CAGR of 11.6% to FY16F. Yield on interest earning assets are expected to shed 35bps y/y to 11.5% in FY14F, while cost of funds are expected to shed 36bps y/y to 4.1%, translating to stability in Net Interest Margins (+1bps) at 7.7% in FY14F. Loans and advances are expected to grow at a 3 year CAGR of 22.7% in FY16, while total government securities are to grow at a 3 year CAGR of 24.0% in FY16F. We highlight that DTB has the advantage of extra leg room to lower its cost of funds further than tier I banks, by lowering its deposit rates, hence protecting its NIMs. As at FY13, DTB's cost of funds stood at 4.4%, relative to the tier I and tier II banks cost of funds average of 2.7% and 4.4%. As at FY13, DTB's interest earning assets are comprised of 76.4% as loans and advances, 17.5% as Government securities and 6.1% as deposits and balances due from banking institutions. We forecast the bank's interest earning assets in FY14F to be comprised of 74.5% as loan and advances, 6.0% as deposits and balances due from banking institutions and 19.6% as Government securities, as proceeds from the Rights Issue are initially channeled to Government securities purchase, before being redirected to loan book expansion.



Source: Company

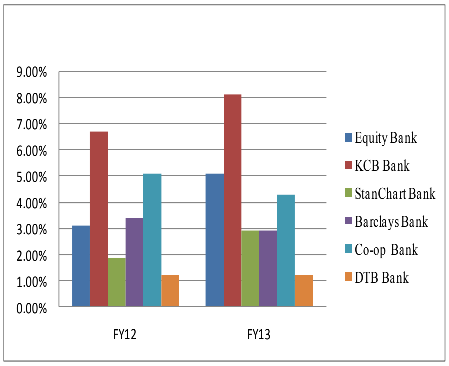
Core liability growth to continue keeping pace with asset growth going forward: We expect DTB to grow its loan book at a 3 year CAGR of 22.7% to FY16F (+23.0% y/y to KES 136.1bn in FY14F), on the back of increased long term credit demand. Customer deposits are to grow at a 3 year CAGR of 21.7% to FY16F, resulting to a loans-to-deposits ratio of 85.6%, 86.5% and 88.9% in FY14F, FY15F and FY16F respectively. The 3 sectors that accounted for the largest portion of DTB's loan book are the Wholesale & Retail trade, Building, Construction & Real Estate and Business & Financial Services which accounted for 22.9%, 20.9% and 16.7% of the bank's customer loans & advances respectively. These sectors contribute to 10.2%, 4.4% and 4.8% of Kenya's GDP and have a 3 year historical average GDP growth rate of 3.6x, 1.0x, and 1.8x GDP growth in that order. In terms of customer segments, 40.0% of DTB's loan book value stems from SMEs, 5.0% from retail customers and 55.0% from large corporates. Individuals and Business & Financial services on the other hand account for 48.0% and 24.7% of customer deposits respectively as at 2013.



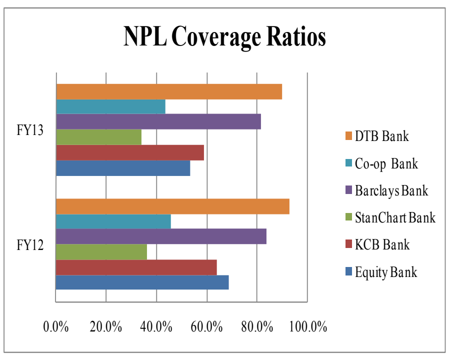


Source: Company

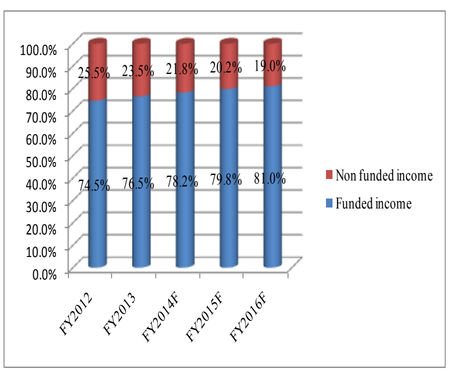
NPL Ratios of Selected Banks



Source: Company, Kestrel Capital estimates



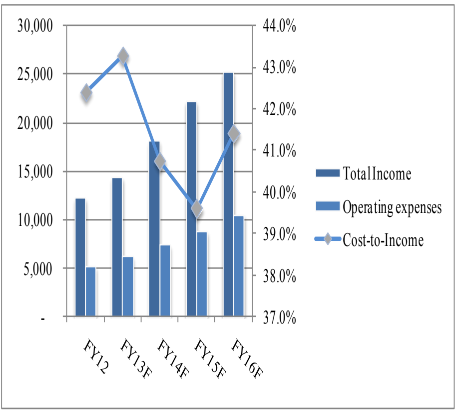
Source: Company, Kestrel Capital estimates



Source: Company, Kestrel Capital estimates

Superior loan book quality to be maintained on the back of prudent credit risk policies: DTB has enjoyed the lowest NPL ratios amongst the listed banks, with a historical 3 year NPL ratio average of 1.1% and a coverage ratio of 98.5% to FY13, against an average of 3.9% and 59.8% respectively. With relatively stable interest rates expected to be maintained in FY14, as evidenced by the Monetary Policy Committee opting to maintain the Central Bank Rate at 8.5% coupled with available investment opportunities, we believe this will result to strong loan uptake from Wholesale and Retail trade, Transport & Communication, Building, Construction & Real Estate and Manufacturing sectors. We also expect DTB's loan book quality to remain superior going forward, with an NPL ratio of 1.2% and a coverage ratio of 96.2% to be achieved in FY14F. We expect the low NPL ratio to be maintained as a fall in NPL is expected from Wholesale and Retail trade, Building and Construction, Manufacturing, Business & Financial Services in FY14F while a possible increase in NPLs in Tourism & Hotels and Transport & Communication sectors observed throughout the banking industry, due to the issued security alerts and travel advisories.

Non-interest income increase driven by fees and commission income growth: We expect DTB's non funded income to note a 3 year forward CAGR of 10.5% to FY16F (+9.2% y/y to KES 3.7bn in FY14F). This will be driven by a 3 year forward CAGR in fees and commission income of 14.3% to FY16F (+14.0% y/y to KES 2.3bn). Fees and commission income growth will stem from increased transactions from its growing regional branch and agency network, increased use of mobile and internet banking services, the growing pre-paid card portfolio as well as trade finance fees from documentary collections, clean collections, negotiation of export bills and bill avalisation services. Recently, DTB Bank got into a Revenue collection contract with Kisii county which has streamlined the county's revenue collection and sealed revenue leakages by automating revenue collection for motorists parking, bus parking and *bodaboda* (Motorcycle taxi) monthly license fees. Residents have the option of paying county fees through mobile money (and in the near future through branded cards) through the new revenue collection system. Fees and commission income growth will also be supported by its pre-paid cards-*Nation Hela* which is a partnership with Nation Media targeting diaspora remittances and the *Nakumatt Global* in partnership with Nakumatt Supermarkets, the largest Kenyan retailer. The Nakumatt Global card can be used at any POS terminal as well as make online payments in KES, AUD, EUR, AED, GBP, INR, USD and ZAR currencies. Clients can load the card from any of the 34 Nakumatt outlets or the 48 DTB branches in Kenya and withdraw from any Nakumatt outlet or DTB ATM in the country. The card is not linked to an existing DTB account, but the card's financial details can be managed online, therefore portraying the same features as a typical current bank account. Forex income is however expected to grow modestly, due to expectation that the Kenyan Shilling will remain relatively stable against the major world currencies, with a 3 year forward CAGR of 5.0% to KES 1.4bn (+3.1% y/y to KES 1.3bn in FY14F). This will result in non interest income contribution to total income shedding 171bps, 157bps and 122bps to 20.9%, 18.8% and 17.4% in FY14F, FY15F and FY16F respectively.



Source: Company, Kestrel Capital estimates

Focus on alternative channels of expansion over conservative brick and mortar branch expansion to maintain low CTI going forward: DTB aims to increase the number of branches across the region from 101 to 110 branches by December 2014, with the number of branches in Kenya expected to increase from 49 to 52. The bank plans to grow its agency network from the current 300 agents to 1,500 agents by year end. More so, the pre-paid cards-*NationHela* and *Nakumatt Card* enables owners to top up cash and manage the card's financial details online without being linked to an existing DTB account, therefore portraying features similar to a typical current bank account. The pre-paid cards have resulted to the bank doubling its number of customers. The bank recently upgraded its core banking system in FY13 by procuring a newer version of Flexcube. This has improved its information system speed and efficiency, thereby increasing transaction capacity per unit time and providing Graphical User Interface to make internet banking more user friendly. This will therefore result in increased use of internet and mobile banking services, relative to physical service provision. DTB currently has 3 virtual banking solutions; DTB mail (retail centric internet banking), DTB 24/7 mobile banking and DTB iBank (internet banking solutions focused on corporate banking). In light of operating expenses growing at a slower rate to total income, a 40.6% Cost to Income ratio is forecasted in FY14F (-255bps y/y).

Rights Issue proceeds to grow DTB's investment in subsidiaries and its asset base in Kenya: DTB is seeking to raise KES 3.6bn (USD 41.7m) by way of Rights Issue. Proceeds from the Rights Issue will be used to:

- Grow DTB (K)'s asset base, fund investment in branch network and alternative delivery channels and boosting DTB (K)'s capital adequacy
- Strengthen the Group's presence through additional investment in subsidiaries to improve balance sheet and profitability growth in them
- Invest in a new regional market. DTB is expected to venture into a new market-possibly within the next 24 months. DTB is considering Rwanda, Madagascar, Democratic Republic of Congo (DRC) and Mozambique

Source: Company

Negatives

Low dividend yield expected going forward: Based on the current price of KES 248.00, DTB's dividend yield stands at 0.9%, against a sector average of 3.3%. DTB's 5 year historical dividend payout ratio stands at 13.1% and we expect this to remain conservative going forward, with estimated DPS of KES 2.20, KES 2.40 and KES 2.60 to paid out in FY14F, FY15F and FY16F respectively. We however believe that DTB will opt to reinvest earnings in branch network expansion and boost core capital/Total risk weighted asset ratio further, given the revised statutory ratio of 10.5% from 8.0% (effective from January 2015). The bulk of DTB's income stems from interest income (74.0% in FY13), with 82.4% of interest income attributable from loan and advances, hence the need to retain profits to provide head room for loan book growth. We therefore forecast a core capital/Total risk weighted assets ratio of 18.3% in FY14F due to high attributable income retention and Rights Issue proceeds.

Capital strength	FY2012	FY2013	FY2014F	FY2015F	FY2016F
Core capital (Tier 1)	15,750	20,215	29,173	35,959	44,446
Supplementary capital (Tier 2)	3,983	5,915	7,089	8,278	9,852
Total capital	19,733	26,130	36,262	44,236	54,297
Total risk weighted assets	93,962	119,296	124,095	162,735	191,048
Core capital / TRWA	16.8	16.9	23.5	22.1	23.3
Total capital / TRWA	21.0	21.9	29.2	27.2	28.4
Core capital/deposits	14.7	15.7	18.3	18.3	19.3

Source: Company, Kestrel Estimates

Key Rights Issue Details

Key Rights Issue Dates	Date
Record date	24-Jun-14
Rights Issue opens	30-Jun-14
Trading of rights commences on the NSE	02-Jul-14
Last day for trading rights	15-Jul-14
Rights issue closes	25-Jul-14
Last date for acceptance of and payment for New shares, Additional shares and Rump allotment shares	25-Jul-14
Last date of payment for *IBGs for the additional / rump allotment shares	15-Aug-14
Date of listing and commencement and trading of New Shares on the NSE	26-Aug-14

*Irrevocable Bank Guarantee

Key Rights Issue Investment Data	
Rights Issue Ratio	1:10
Rights Issue Price (KES)	165.00
New shares in Rights Issue (m)	22.0
Post Rights fully paid ordinary shares (m)	242.1
Gross Rights Issue proceeds (KES bn)	3.6

All eligible DTB shareholders and purchasers of rights (via the NSE) who accept their entitlement shall receive their full number of shares applied for. The balance of new shares not successfully applied for (untaken rights) will be available for allocation to the applicants for additional shares. In the event that the application for additional shares results in an oversubscription, applications for additional shares will be allocated on a pro-rata basis on the basis of size of application for additional rights. Any remaining shares not successfully applied for in the entitlement and additional allocation will be available for allocation to the applicants for Rump allotment shares. Rump allotment is a mechanism that allows eligible shareholders and purchasers of Rights to make applications of a minimum of 60,000 shares, in the specific case of DTB. It allows the sale of new shares not taken up as per the entitlement and additional shares. Any remaining new shares not taken up after the rump allotment will lapse.

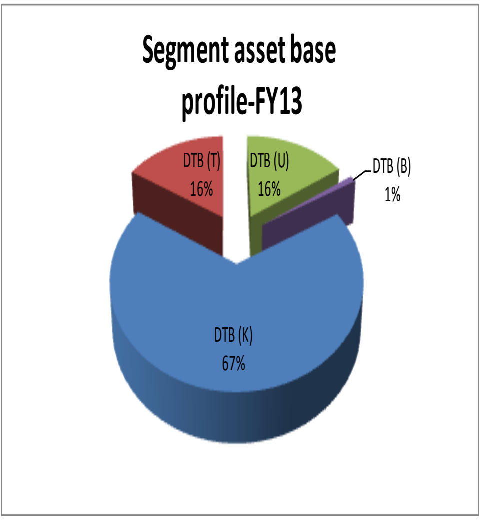
Performance of DTB against 4 East African banking sectors

Economic Indicators-2013 est.	Kenya	Uganda	Tanzania	Burundi
GDP-Purchasing Power Parity (USD bn)	79.9	54.4	79.3	5.8
GDP: 2 year CAGR (%)	4.8	4.2	7.0	4.2
GDP per Capita (USD)	1,800.0	1,500.0	1,700.0	600.0
Gross National Saving (% of GDP)	10.6	17.4	25.7	-0.9

Source: CIA fact book

DTB-Regional Presence

Source: Kestrel Capital Research



Source: Company

Diamond Trust Bank Group has recorded strong loan book and deposits growth, growing faster than the regional banking sector loan book and deposits. DTB Group has recorded a 3 year CAGR in loans and deposits of 29.4% and 24.8% respectively to FY13. The cumulative loan book and deposits growth of Kenya, Uganda, Tanzania and Burundi recorded a 3 year CAGR in loans and deposits of 17.4% and 14.8% respectively to FY13.

Kenya

The Kenyan banking sector includes 43 commercial banks, 1 mortgage finance company, 9 deposit taking microfinance institutions, 7 representative offices of foreign banks, 105 forex bureaus and 2 credit reference bureaus. Out of Kenya's population of 39.7m, 32% live in urban areas with 7.6% of the total population living in Kenya's capital, Nairobi. The Kenyan banking sector has experienced a 3 year CAGR of 17.2% and 18.7% in assets and liabilities respectively to FY13. DTB (K) has outpaced the banking sector growth, by recording a 3 year CAGR of 24.9% and 23.6% in assets and liabilities respectively over the same time period. DTB group's asset quality remains superior to the industry's average at 1.2% as at December 2013, vis-à-vis the sector's average of 5.2%.

Uganda and Tanzania

Uganda's banking sector is comprised of 25 commercial banks, 3 credit institutions and 66 forex bureaus, while Tanzania's banking sector encompasses 38 commercial banks and 7 community banks. Out of Tanzania's population of 48 million, 28% live in urban areas. The Tanzanian and Ugandan banking sectors have recorded a 3 year CAGR of 15.4% and 15.1% respectively in assets to FY13. DTB (T) and DTB (U) grew at a significantly faster rate than the respective banking sectors, recording an impressive 3 year CAGR in assets of 23.0% and 38.3% respectively to FY13.

Burundi

Burundi's banking sector is comprised of 9 commercial banking institutions and 46 forex bureaus. Out of Burundi's population of approximately 10 million, over 90.0% percent of them are employed in the agriculture sector, which accounts for roughly 30.0% of the country's GDP. Burundi's banking sector has recorded a 3 year CAGR of 9.8% in total assets to FY13. DTB (B) however recorded modest growth over the same period, recording a 3 year CAGR of 2.2%. DTB (B) was established in 2009, and first recorded profits in 2011, and is therefore still relatively young. Modest sector growth aside, we believe the key to growing DTB (B)'s loan book is through aggressive lending to agribusinesses.

Valuation of Diamond Trust Bank

Relative Valuation Analysis (RVA)

Our fair value per share over the forecast period is derived using Relative Value Analysis (RVA). Our discount rate (cost of equity) assumption of 16.5%, was based on Risk free rate (11.0%), Market Risk premium (6.0%) and a Beta coefficient of 0.916. A nominal, long-term sustainable growth rate of 10.0% was used, with real GDP growth rate of 5.0% and an inflation rate of 5.0% assumed.

Our Price to Book (P/B) approach is based on a 2 year holding period to derive our valuation.
We estimate a sustainable sector P/B multiple of 2.0x for the Kenyan banking sector, which reflects a fair valuation in view of the sector's medium term fundamentals. Estimated dividends (gross) will accrue to shareholders over the forecasted period. We discount our forecasted cash flows with our cost of equity (16.5%).

P/B Valuation (x)	
2 year sector exit PB	2.0
2 year Exit PB relative	0.75
Derived 2 year exit PB	1.50
Interpolated forecast NAV	159.22
Derived 1 year exit NAV	238.82
PV of NAV	220.12
After tax DPS forecast	6.55
Per Share Fair Value	**226.67**
Cost of Equity	16.5%
1 year Target Price	**264.07**

Source: Kestrel Capital estimates

Theoretical ceiling-DTB Rights Trading Price

We derive a theoretical price ceiling for DTB Rights which are going to trade in the market, supplied by investors who are not looking to take up their Rights.

Current market price	241.00
Rights Issue Price	165.00
Implied Rights Value	**76.00**

1Q14 earnings review

Income Statement (KES 000)	1Q13	4Q13	1Q14	y/y %ch	q/q% ch
Interest income	3,959,366	4,786,038	4,895,653	23.6	2.3
Interest expense	1,480,459	1,725,014	1,885,700	27.4	9.3
Net interest income	2,478,907	3,061,024	3,009,953	21.4	(1.7)
Other operating income	19,760	36,029	64,707	227.5	79.6
Fees & commission income	465,340	551,648	502,736	8.0	(8.9)
Forex income	302,582	313,943	374,717	23.8	19.4
Total non-interest income	787,682	901,620	942,160	19.6	4.5
Total income	3,266,589	3,962,644	3,952,113	21.0	(0.3)
Less operating expenses	1,432,870	1,700,476	1,752,768	22.3	3.1
Operating profit	1,833,719	2,262,168	2,199,345	19.9	(2.8)
NPL provision	110,139	356,236	126,117	14.5	(64.6)
Profit from Associates	3,394	2,039	1,202	(64.6)	(41.0)
Profit before tax	1,726,974	1,907,971	2,074,430	20.1	8.7
Less tax	(577,408)	(560,253)	(702,306)	21.6	25.4
Profit after tax	1,149,566	1,347,718	1,372,124	19.4	1.8
No. of ord shares	220,100	220,100	220,100	0.0	0.0
EPS (KES)	5.22	6.12	6.23	19.4	1.8
Trailing EPS (KES)	17.59	21.61	22.62		

Balance Sheet (KES 000)	1Q13	FY13	1Q14	y/y %ch	q/q% ch
Ordinary Share Capital	880,400	880,400	880,400	0.0	0.0
Share Premium	3,856,898	3,856,898	3,856,898	0.0	0.0
Retained Earnings	12,159,020	15,477,589	16,683,251	37.2	7.8
Other equity component	604,831	735,968	669,449	10.7	-9.0
Total shareholders' equity	17,501,149	20,950,855	22,089,998	26.2	5.4
Non controlling Interest	2,384,661	2,793,449	2,918,238	22.4	4.5
Deposits to other banks	3,801,054	4,718,312	2,061,279	-45.8	-56.3
Customer deposits	107,366,356	128,788,398	134,296,712	25.1	4.3
Other liabilities	7,619,556	9,269,337	10,018,560	31.5	8.1
Total equity and liabilities	138,672,776	166,520,351	171,384,787	23.6	2.9
Central bank balances	9,488,487	9,048,533	10,146,002	6.9	12.1
Other bank balances	10,042,827	8,786,032	7,865,885	(21.7)	-10.5
Government securities	14,035,449	17,832,375	18,484,845	31.7	3.7
Customer loans and advances	90,850,922	110,945,439	114,970,766	26.5	3.6
Other assets	11,317,062	15,028,726	15,161,426	34.0	0.9
Fixed assets	2,938,029	4,879,246	4,755,863	61.9	-2.5
Total assets	138,672,776	166,520,351	171,384,787	23.6	2.9

	1Q13	FY13	1Q14	y/y bps ch
Yield on interest earning assets (%)*	13.8	13.9	13.9	8
Cost of funds (%)*	5.3	5.2	5.5	20
NIMs (%)*	8.5	8.7	8.3	(13)
Non funded income/total income (%)	24.1	22.8	23.8	(27)
CTI (%)	43.9	42.9	44.4	49
Loan/Deposit (%)	84.6	86.1	85.6	99
NPL Ratio (%)	1.2	1.2	1.2	1
NPL Coverage Ratio (%)	86.1	98.5	89.3	314
ROA (%)*	3.3	3.2	3.2	(11)
Core Capital/TRWA (%)	14.6	17.1	16.0	140
Total Capital/TRWA (%)	17.4	20.5	17.8	40

	DTB	Sector Avg
VWAP (05/08/2014) (KES)	235.00	
Trailing P/E (x)	10.4	10.7
Trailing P/B (x)	2.3	2.2
ROE (%)	21.9*	21.5
Div. Yld (%)	0.9	3.3

Note: * quarterly ratios have been annualized

Source: Company, Kestrel Capital estimates

Diamond Trust Bank (DTB) Group released 1Q14 results, posting a 19.4% y/y increase in Profit After Tax to KES 1.4bn. The impressive earnings were driven by a sturdy net interest and non-interest income growth, paired by a stable Cost-to-Income ratio (+44bps y/y) of 44.4% in 1Q14. The earnings are in line with our expectations as per our pre-Rights Issue report released in March 2014 (FY14 EPS forecast: +18.5% y/y to KES 25.60, prior to Rights Issue).

We highlight the key earnings drivers below:

- **Net Interest Income was up 21.4% y/y (-1.7% q/q) as interest expense grew faster than interest income:** DTB recorded 21.4% y/y (-1.7% q/q) growth in Net interest income to KES 3.0bn, on the back of 23.6% y/y interest income growth (+2.3% q/q), while interest expenses declined 17.1% y/y to KES 6.2bn. Interest income from loans and advances was up 27.8% y/y to KES 4.1bn, accounting for 84.1% of total interest income in 1Q14. Interest expenses from deposits however grew at a faster rate than interest income (+26.2% y/y to KES 1.9bn), while other interest expenses increased 89.1% y/y to KES 51.8m, as DTB Group's borrowed funds grew 56.3% y/y to KES 5.8bn. This translated to a 13bps y/y decrease in annualized Net Interest Margins (NIMs) to 8.3%, as cost of funds increased 20bps y/y to 5.5%, while annualized yield on interest earning assets gained 8bps y/y to 13.9%.
- **Non-funded income was up 19.6% y/y to KES 787.7m:** This was driven by a 23.8% y/y growth in income from forex dealings. Fees and Commission income however grew at a modest rate of 8.0% y/y to KES 465.3m. The above saw non-funded income account for 23.8% of total income in 1Q14 (-27bps y/y). All the above translated to a 21.0% y/y growth in total income to KES 4.0bn.

- **Operating expenses were up 22.3% y/y to KES 1.8bn, noting higher y/y growth, relative to total income:** CTI ratio increased by 49bps y/y to 44.4% in 1Q14, owing to 12.1% y/y growth in staff costs to KES 714.2m and 30.8% y/y increase in other expenses to KES 704.0m. Rental expenses declined marginally (-7.1% y/y to KES 101.9m), as DTB Kenya moved to its new building (DTB Centre) in 2H14 and we therefore expect a slightly moderate growth in rental income in FY14 from letting out extra space. The group recorded 14.5% y/y increase in bad debt charge to KES 126.1m.
- **The balance sheet noted sound y/y growth, owing to an impressive 26.5% y/y loan book growth:** Net loans and advances to customers recorded a 26.5% y/y (+3.6% q/q) increase to KES 115.0bn. Customer deposits were up 25.1% y/y and 4.3% q/q to see the loan-to-deposit ratio increase 99bps y/y to 85.6% in 1Q14. We expect the loan book to continue recording strong growth going forward, especially among SMEs due stable interest rates and macroeconomic environment. DTB Bank boasts one of the highest loan book quality, with an NPL ratio of 1.2% compared to a sector average of 4.4%. While Gross NPLs less interest in suspense were up 26.9% y/y to KES 1.3bn, the NPL coverage ratio improved 314bps y/y to 89.3%. We believe certain NPLs have resumed payments, but are yet to meet the minimum 6 month consistent payment criteria necessary for an upgrade to "watch" loans.
- **Core Capital/Total risk weighted assets ratio improved (+140 bps y/y) to 16.0% in 1Q14**, while total capital/total risk weighted assets ratio was up 40bps y/y to 20.5%. This remains above the 14.5% statutory ratio, as per the new CBK prudential guidelines (effective by end of 2014). DTB's borrowed funds were up 56.3% y/y to KES 5.8bn. We believe this was due to the group receiving its first tranche of the USD 40.0m senior loan from the International Finance Corporation (IFC) to boost tier II capital. The core capital/total risk weighted assets ratio of 16.0% stands at 550bps above the new 10.5% minimum statutory ratio.
- **DTB trades at P/E and P/B multiples of 10.4x and 2.3x based on an EPS and NAV/Share of KES 22.62 and KES 100.36**, against a sector average of 10.7x and 2.2x. The group's annualized ROE stands at 21.9% against a sector average of 21.5%. Going forward, we believe that bottom line growth in FY14 will arise from organic growth, continued cost management initiatives and improved revenue contributions from regional subsidiaries. Notably, DTB is seeking to raise funds by way of a Rights Issue in 2H14. Based on the current number of issued shares (220.1m shares), this will translate to a Rights Issue on the basis on 1 share for every 10 held. We expect this to boost capital adequacy, support onward lending going forward and provide for further regional expansion for DTB Bank, as we expect banks to focus on loan book and trade finance growth in 2014. We therefore recommend an **ACCUMULATE** on DTB Bank with a **fair value of KES 250.00**.

Financial summary

Income statement (KES m)	FY12	FY13	FY14F	FY15F	FY16F	1yr ch %	3yr CAGR %
Net interest income	9,125	11,003	13,982	17,762	21,634	27.1	25.3
Non funded income	3,115	3,378	3,689	4,109	4,564	9.2	10.5
Total income	12,240	14,380	17,671	21,871	26,198	22.9	22.1
Less operating expenses	5,189	6,223	7,398	8,798	10,468	18.9	18.9
Operating profit	7,052	8,158	10,273	13,073	15,729	25.9	24.5
Bad debt provision	1,026	927	1,089	1,358	1,639	17.5	20.9
Profit Before Tax	6,026	7,231	9,184	11,715	14,090	27.0	24.9
Less tax	(1,960)	(2,004)	(2,756)	(3,633)	(4,087)	37.5	26.8
Profit After Tax	4,068	5,231	6,432	8,086	10,007	23.0	24.1
Minority interest	440	474	572	720	891	20.7	23.4
Net income	3,628	4,757	5,859	7,367	9,116	23.2	24.2
Weighted shares (m)	208	220	242	242	242	10.0	3.2
Year end shares (m)	220	220	242	242	242	10.0	3.2
EPS (KES)	17.48	21.61	24.20	30.43	37.65	12.0	20.3
DPS (KES)	1.90	2.10	2.20	2.40	2.60	4.8	7.4
Balance sheet (KES m)							
Central bank balances	11,509	12,709	16,709	20,805	21,736	31.5	19.6
Placements with other banks	7,723	8,786	10,891	13,629	16,087	24.0	22.3
Government securities	22,745	25,446	35,756	41,232	48,564	40.5	24.0
Net loans and advances	87,707	110,945	136,139	169,714	204,881	22.7	22.7
Fixed assets	2,770	4,879	4,969	6,171	7,133	1.8	13.5
Other assets	3,008	3,755	4,412	4,352	3,980	17.5	2.0
Total assets	135,461	166,520	208,877	255,903	302,381	25.4	22.0
Total shareholder's equity	16,522	20,951	29,979	36,840	45,480	43.1	29.5
Minority Interest	2,105	2,793	3,606	4,549	5,512	29.1	25.4
Placements from other banks	2,727	4,718	5,736	6,702	7,834	21.6	18.4
Customer deposits	106,975	128,788	159,133	196,273	230,408	23.6	21.4
Other liabilities	7,133	9,270	10,424	11,539	13,147	12.4	12.4
Total equity and liabilities	135,461	166,520	208,877	255,903	302,381	25.4	22.0

Ratios (%)	FY12	FY13	FY14F	FY15F	FY16F
Yield on interest earning assets	14.0	11.8	11.5	11.3	11.2
Cost of Funds	6.6	4.4	4.1	3.7	3.5
Net Interest Margins	7.5	7.4	7.4	7.7	7.7
Cost to income ratio	42.4	43.3	41.9	40.2	40.0
Net profit margin	29.6	33.1	33.2	33.7	34.8
Non funded income to total income	25.5	23.5	20.9	18.8	17.4
Profitability ratios (%)					
Return on average assets	3.0	3.2	3.1	3.2	3.3
Return on average equity	25.8	25.4	23.0	22.0	22.1
Balance sheet ratios (%)					
Net advances to deposits ratio	82.0	86.1	85.6	86.5	88.9
Net advances to borrowed funds and deposits ratio	79.2	82.5	82.0	83.0	85.3
Advances to total assets	64.7	66.6	65.2	66.3	67.8
Government securities to total assets	16.8	15.3	17.1	16.1	16.1
NPL ratios					
NPL ratio (%)	1.2	1.2	1.2	1.2	1.2
NPL Coverage ratio (%)	92.7	98.4	96.2	94.8	93.7

Source: Company, Kestrel Capital estimates

Peer Comparables

Cost of Funding (%)	FY10	FY11	FY12	FY13
Equity Bank	2.2	2.3	3.5	2.6
KCB Bank	1.8	1.7	4.2	2.8
Barclays Bank	0.9	0.6	2.1	1.6
Standard Chartered Bank	1.2	1.4	3.8	2.8
Co-op Bank	2.6	2.7	5.2	3.1
Diamond Trust Bank	4.1	4.2	6.6	4.4
Simple Average	**2.1**	**2.1**	**4.4**	**2.4**
Weighted Average	**2.0**	**2.0**	**4.1**	**2.4**

Net Interest Margin (%)				
Equity Bank	12.2	12.4	13.9	12.0
KCB Bank	10.8	9.8	10.9	9.8
Barclays Bank	11.1	11.7	11.9	11.2
Standard Chartered Bank	7.1	7.1	9.0	8.4
Co-op Bank	7.6	7.4	9.9	9.3
Diamond Trust Bank	7.4	8.0	7.4	7.9
Simple Average	**9.4**	**9.4**	**10.5**	**9.8**
Weighted Average	**9.7**	**9.6**	**10.8**	**9.9**

Non Interest to total Income (%)				
Equity Bank	47.1	43.4	34.9	36.7
KCB Bank	35.9	40.8	33.8	34.2
Barclays Bank	39.8	38.0	33.8	32.5
Standard Chartered Bank	40.8	39.7	32.2	28.1
Co-op Bank	41.8	40.9	56.7	33.2
Diamond Trust Bank	37.5	29.3	25.5	23.5
Simple Average	**40.5**	**38.7**	**36.2**	**31.3**
Weighted Average	**40.3**	**39.6**	**36.4**	**32.2**

Cost to Income ratio (%)				
Equity Bank	51.0	50.1	48.8	48.5
KCB Bank	61.1	56.7	57.4	54.0
Barclays Bank	54.0	51.6	52.0	52.9
Standard Chartered Bank	42.6	40.9	40.8	40.0
Co-op Bank	52.7	50.9	56.7	59.5
Diamond Trust Bank	47.6	48.1	42.4	43.3
Simple Average	**51.5**	**49.7**	**49.7**	**49.7**
Weighted Average	**52.9**	**50.7**	**51.0**	**50.5**

Operating Profit Margin (%)				
Equity Bank	46.3	49.3	51.2	51.5
KCB Bank	38.9	43.3	45.3	46.0
Barclays Bank	46.0	48.4	48.0	47.1
Standard Chartered Bank	57.4	59.1	59.2	60.0
Co-op Bank	30.2	30.2	43.3	40.5
Diamond Trust Bank	52.4	51.9	57.6	57.1
Simple Average	**45.2**	**47.0**	**50.8**	**50.4**
Weighted Average	**44.0**	**46.3**	**49.8**	**49.5**

Return on Average Assets (%)	FY10	FY11	FY12	FY13
Equity Bank	5.8	6.1	5.5	5.3
KCB Bank	3.2	3.8	3.5	3.8
Barclays Bank	4.6	4.8	5.0	5.0
Standard Chartered Bank	4.0	4.1	4.5	4.2
Co-op Bank	2.9	3.1	4.2	3.9
Diamond Trust Bank	3.0	2.8	3.0	3.1
Simple Average	**3.9**	**4.1**	**4.3**	**4.2**
Weighted Average	**3.9**	**4.2**	**4.3**	**4.2**

Return on Average Equity (%)				
Equity Bank	28.5	33.6	31.3	29.7
KCB Bank	23.2	26.3	25.0	24.4
Barclays Bank	28.1	26.6	30.9	24.6
Standard Chartered Bank	31.3	29.5	31.4	26.0
Co-op Bank	25.0	24.3	30.1	25.4
Diamond Trust Bank	28.7	26.1	25.8	22.4
Simple Average	**27.5**	**27.7**	**29.1**	**25.4**
Weighted Average	**26.9**	**27.8**	**28.8**	**25.6**

Net Advances to Deposits (%)				
Equity Bank	75.0	79.0	80.8	87.8
KCB Bank	75.2	76.6	73.5	74.5
Barclays Bank	70.4	79.8	75.6	78.3
Standard Chartered Bank	60.0	67.9	80.2	83.8
Co-op Bank	60.8	67.8	73.4	78.1
Diamond Trust Bank	77.4	82.9	82.0	86.1
Simple Average	**69.8**	**75.7**	**77.6**	**81.4**
Weighted Average	**70.3**	**75.5**	**77.0**	**80.6**

P/E (x)				
Equity Bank	11.0	7.6	9.2	9.0
KCB Bank	10.0	6.5	9.4	9.8
Barclays Bank	9.8	9.5	10.3	11.5
Standard Chartered Bank	10.8	9.8	11.2	10.7
Co-op Bank	8.4	6.4	8.2	9.2
Diamond Trust Bank	8.2	7.0	8.8	10.6
Simple Average	**9.7**	**7.8**	**9.5**	**10.1**
Weighted Average	**9.8**	**7.6**	**9.5**	**10.0**

Dividend Yield (%)				
Equity Bank	3.8	4.7	4.2	4.7
KCB Bank	5.2	7.6	4.9	4.2
Barclays Bank	9.7	10.7	7.8	4.3
Standard Chartered Bank	6.9	7.1	4.3	4.6
Co-op Bank	2.7	3.5	3.3	2.5
Diamond Trust Bank	1.7	1.8	1.3	0.9
Simple Average	**5.0**	**5.9**	**4.3**	**3.5**
Weighted Average	**5.1**	**6.2**	**4.5**	**3.8**

P/B (x)				
Equity Bank	2.9	2.3	2.6	2.3
KCB Bank	1.8	1.6	2.1	2.2
Barclays Bank	2.4	2.6	3.1	2.7
Standard Chartered Bank	2.8	2.9	2.9	2.7
Co-op Bank	1.9	1.6	2.1	2.3
Diamond Trust Bank	2.1	1.6	1.9	2.4
Simple Average	**2.3**	**2.1**	**2.5**	**2.4**
Weighted Average	**2.3**	**2.1**	**2.4**	**2.4**

Recommendation guide

STRONG BUY:	Highly undervalued/ strong fundamentals
BUY:	Good value/ strong fundamentals
ACCUMULATE:	Buy on price dips
HOLD:	Correctly valued with little pricing upside or downside
LIGHTEN:	Overvalued by the market/ Reduce exposure/Declining fundamentals/ industry concerns
SELL:	Weak fundamentals and challenging operating environment/Highly overpriced

Disclaimer