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Diamond Trust Bank Kenya Limited

Kenya Bank Analysis **May 2018**

Rating class	Rating scale	Rating	Rating outlook	Expiry date
Long-term	National	A+(KE)	Stable	May 2019
Short-term	National	A1(KE)		

Financial data:

(USDm comparative)

	31/12/16	31/12/17
KES/USD (avg.)	101.52	103.20
KES/USD (close)	102.99	103.15
Total assets†	3 425.1	3 520.4
Tier 1 capital‡	400.7	466.8
Tier 2 capital‡	71.8	62.6
Net advances	1 808.9	1 900.6
Liquid assets	1 240.6	1 454.3
Operating income	240.2	240.4
Profit after tax	76.1	67.1
Market cap. #	KES58.7bn/USD0.6bn	
Market share*		6.7%

† Including off-balance sheet items, excluding intangible assets (goodwill).
‡ Refers to the calculation of regulatory capital as per banking regulations.
# Market capitalisation as at 10 May 2018.
* Based on CBK's calculation of total banking industry assets at 31 December 2017.

Rating history:

Initial rating (September 2011)
Long-term rating: A+(KE)
Short-term rating: A1(KE)
Rating outlook: Stable

Last rating (May 2017)
Long-term rating: A+(KE)
Short-term rating: A1(KE)
Rating outlook: Stable

Related methodologies/research:

Global Criteria for Rating Banks and Other Financial Institutions, updated March 2017
Kenya Bank Statistical Bulletin (December 2017)
DTB rating reports (2011-17)

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Summary rating rationale

- The ratings accorded to Diamond Trust Bank Kenya Limited ("DTB" or "the group") reflect its long history, its growing franchise in a challenging operating environment, and robust regional footprint (representing operations in Kenya, Uganda, Tanzania, and Burundi). GCR has also taken into consideration the acquisition of Habib Bank Limited ("HBL") effective September 2017. Furthermore, the ratings are supported by strong capitalisation and improving liquidity. Offsetting these key rating strengths is weakening asset quality and a decline in profitability.
- The group's capitalisation metrics improved, with total regulatory capital growing by 12.2% during FY17 (FY16: 11.0%), to KES54.6bn supported by retained earnings and the acquisition of HBL Kenya. The group's total capital adequacy ratio ("CAR") increased to 23.3% at FY17 (FY16: 20.2%), well above the prevailing regulatory minimum of 14.5% at FY17 and the highest CAR amongst the Top 11 banks in Kenya. DTB's capitalisation provides an adequate buffer against unexpected losses in the short- and medium-term.
- The group saw an improvement in its liquidity position, at FY17 with the ratio of liquid assets/short-term funding at 52.3% (FY16: 48.9%) and the net advances/total funding ratio decreasing to 64.5% (FY16: 68.4%). The group manages liquidity risk through internal models and calculations carried out by the Asset and Liability Committee. DTB ensures that there is sufficient liquidity to meet maturing deposit obligations and withdrawals and absorb any short-term or medium-term unplanned cash withdrawals resulting from financial and/or economic stress.
- Total liability funding grew by 9.4% to KES303.9bn at FY17 (FY16: 21.5%). The group is predominantly funded by customer deposits, which contributed a higher 87.6% (FY16: 85.7%) of the funding base at FY17. Borrowings declined to 5.7% of the funding base at FY17 from 7.9% at FY16.
- The group's asset quality metrics weakened in FY17 with gross non-performing loans ("NPLs") increasing significantly by 115.6% to KES13.1bn at FY17 (FY16: 41.6% increase), which was mainly attributed to economic challenges in East African economies, resulting in a cash crunch, reduced investments and reclassification of stressed loans which went into default status during the review period. Consequently, the gross NPL ratio increased to 6.3% at FY17 from 3.1% at FY16 but remained below the market average of 10.8%. The group's collateral against its NPL book is considered adequate with a specific provision coverage of 63.1% of NPLs at FY17 (FY16: 82.1%).
- The group's profitability declined with net profit before tax ("NPBT") decreasing by 8.2% to KES10.1bn (FY16: KES11.0bn) as a result of a decline in interest income and an 8.5% decrease in trading income, while operating expenditure grew by 14.8%. Consequently, the group's ROaA and ROaE decreased to 2.0% and 15.5% at FY17 (FY16: 2.6% and 20.6%) respectively.

Factors that could trigger a rating action may include

Positive change: The group's ratings could be positively impacted by a significant improvement in asset quality, and profitability metrics coupled by an improvement in the operating environment.

Negative change: The ratings could be negatively affected by a sustained reduction in asset quality, further decline in earnings power and erosion of the bank's capital base.

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Organisational profile

Business overview[1]

DTB is a regional bank incorporated in the Republic of Kenya and operates as a public company listed on the Nairobi Securities Exchange. The group was licensed by the Central Bank of Kenya ("CBK") as a commercial bank in 1997 and offers a wide range of corporate, retail and commercial banking services, targeting mainly Small and Medium Enterprises ("SMEs"). DTB is an affiliate of the Aga Khan Fund for Economic Development ("AKFED"), the economic development arm of the Aga Khan Development Network which has operated in the East African market for over 70 years. DTB expanded across East Africa, establishing operations in Kenya, Uganda, Tanzania and Burundi. DTB's Kenyan operations contributed 74.3% of total assets at FY17.

In line with the group's business strategy, "DTB Vision 2020" which sought to position DTB as a Tier 1 player in the market in which it operates, it acquired HBL's Kenyan branches, a global banking group headquartered in Karachi, Pakistan and listed on the Pakistani Stock Exchange ("PSE") in August 2017. HBL was established in 1941 and has been operating in Kenya since 1956. DTB's equity investments (in addition to its own Kenyan banking activities) are depicted in Table 1.

Table 1: DTB Kenya's beneficial investments	FY16	FY17
Subsidiaries:	**%**	**%**
Diamond Trust Bank Tanzania Limited	65.7	65.7
Diamond Trust Bank Uganda Limited	61.7	67.2
Diamond Trust Bank Burundi S.A.	67.3	67.3
Diamond Trust Insurance Agency Limited	100.0	100.0
Premier Savings and Finance Limited	100.0	100.0
Associates:	**%**	
Services and Systems Limited	40.0	40.0
Jubilee Insurance Company of Burundi S.A.	20.0	20.0

Source: DTB.

Ownership structure

Table 2 provides a breakdown of the group's main shareholders at 31 December 2017.

Table 2: Shareholding structure	Country of incorporation	%
Aga Khan Fund for Economic Development	Switzerland	16.5
Habib Bank Ltd	Pakistan	16.2
The Jubilee Insurance Company of Kenya Ltd	Kenya	9.9
Standard Chartered Nominees A/C KE18972	Kenya	1.9
Standard Chartered Nominees A/C KE18965	Kenya	1.9
The Diamond Jubilee Investment Trust Ltd	Uganda	1.4
Standard Chartered Nominees A/C KE002382	Kenya	1.3
Standard Chartered Nominees A/C KE11752	Kenya	1.0
CFC Stanbic Nominee Limited A/C NR1873738	Kenya	1.0
Other shareholders (<1%)	-	47.7
Total		**100.0**

Source: DTB.

[1] Refer to GCR's previous rating reports for a detailed background.

Strategy and operations

DTB has embarked on developing its new business strategy, *DTB Strategy 2030 and Beyond*, having largely met the objectives of *DTB Vision 2020* which aimed to make DTB a Tier 1 bank in all markets it operates in with a "one bank, one customer" omnichannel bank value proposition, providing seamless and consistent consumer experience across borders through traditional banking and digital channels. Once developed, *DTB Strategy 2030 and Beyond,* will aims to lay the roadmap for DTB to grow its brand as a leading business bank in East Africa by expanding its niche SME customer base, as well as widening its spectrum of customer segments to include the underbanked and unbanked seeking to ultimately improve the quality of life of its customers. It targets positioning the group as a (low cost) liability-driven bank in each of the markets in which it operates.

The group is re-aligning its business model beyond traditional banking (ie, lending and deposit mobilisation) to become a leading payments solution provider for an increasingly discerning and technology-driven customer base. DTB focuses on developing and offering innovative solutions to its customers. It has thus invested in IT governance, people capacity and capabilities and core infrastructure over the years and leveraging on current and build new partnerships with financial technology ("fintech") companies, mobile telephone operators, card schemes (such as MasterCard, VISA, etc), and develops collaborative and innovative banking solutions targeting various customer segments.

At 31 December 2017, the group's regional operational footprint included 157 ATMs (2016:145), 137 branches (2016: 126), 2,153 staff (2016: 2,197), 1,646 agents (2016: 671), and 1,136,334 customer accounts (2016: 908,501).

Governance structure[2]

The board of directors ("the board") fulfils its obligations through board committees, the composition of which is informed by the CBK, Prudential Guidelines, the Capital Markets Authority Code of Corporate Governance Practices for Issuers of Securities to the Public (2015), and the Kenyan Banking Act ("the Banking Act"). The board-established committees include: Audit and Compliance, Credit, Executive, Information Technology, Nomination and Human Resources, and Risk Management.

DTB is governed by an 11-member board, made up of one executive (the managing director and group chief executive officer) and 10 non-executive directors of which seven are independent. DTB's board is headed

[2] Given the intricacies associated with good corporate governance, GCR recommends an independent assessment to test compliance.

by a non-executive director, ensuring the separation of the roles of the group managing director/group chief executive officer and the board chairman. DTB does extend credit to directors and their associates, on an arm's length basis and on commercial terms. Noting that, the loans are fully secured by tangible collateral and in line with the CBK prudential guidelines and the Banking Act provisions.

Financial Reporting

DTB's consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"). The group's external auditors, KPMG Kenya, issued an unqualified audit opinion on the FY17 financial statements.

Operating environment[3]

Economic overview

Kenya's GDP growth declined to an estimated 5% in 2017 from 5.9% in 2016 due to subdued credit growth caused by caps on commercial banks' lending rates, drought, and the prolonged political impasse over the presidential election. The half-year estimates show that the economy remained fairly resilient, growing 4.8%. Services accounted for 82% of that growth, and industry accounted for 17%. Agriculture's poor performance continued. The economy is projected to rebound to GDP growth of 5.6% in 2018 and 6.2% in 2019.

The central bank retained the policy rate at 10% to anchor inflation at the single-digit level (6.3%). Fiscal policy was expansionary and focused on financing infrastructure mega-projects. Higher government spending, coupled with weaker revenue mobilization, increased the budget deficit to 8% and the public debt to GDP ratio to 54%. The December 2016 International Monetary Fund (IMF)–World Bank Debt Sustainability Analysis put the country at low risk of debt stress. The balance of payments deficit improved slightly to 0.6% of GDP for the year ending June 2017, from 1.7% for the year ending June 2016, on the back of improved current, capital, and financial account balances. This progress increased foreign exchange reserves 0.8%, to a new high of $7.8 billion at end June 2016. The increase in foreign reserves, as well as the precautionary arrangement with the IMF amounting to $1.5 billion, contributed to exchange rate stability. Economic performance in 2017 was mixed. The drought and the presidential election crisis likely affected macroeconomic performance. Inflation increased to an estimated 8.8%; the budget deficit remained high, at an estimated 7.8% of GDP; and the current account deficit increased to an 5.9% of GDP. The economy is projected to be stronger from 2018 onward.

[3] Source: IMF World Economic Outlook (April 2018); CBK Monthly Economic Review (December 2017); Monetary Policy Statement (March 2018); CBK.

Kenya's economy remains resilient due to its diversity; services contributed the highest proportion to GDP growth. This is expected to continue as the country remains the leading regional hub for information and communication technology, financial, and transportation services. Recent investment in rail and road and planned investment in a second runway at Jomo Kenyatta International Airport are potential growth drivers. Macroeconomic stability continues, with most fundamentals projected to remain healthy.

Continued drought in 2017 hindered agricultural productivity and resulted in high inflation for food prices. Prolonged political activities and the presidential election impasse hurt private-sector activity. Although not conclusively assessed, interest rate caps have reportedly constrained credit expansion, leading to reduced private sector investment. Continued high public consumption expenditure keeps the budget deficit at close to 10% of GDP, while the expected maturity of public debt could lead to debt distress.

Industry overview

At 31 December 2017, the banking sector comprised 40 commercial banks; one mortgage finance company, 12 microfinance banks, eight representative offices of foreign banks, 86 foreign exchange bureaus, 14 money remittance providers and three credit reference bureaus.

Table 3: Financial soundness indicators	31 December 2016	31 December 2017
Total assets	KES3.7trn	KES4.0trn
Total advances	KES2.2trn	KES2.3trn
Total deposits	KES2.6trn	KES2.9trn
Capital adequacy ratio	19.7%	18.7%
Gross NPLs/Gross loans	7.5%	8.9%
Provisions/NPLs	42.4%	45.8%
Cost to income ratio	47.7%	49.7%
ROaA	2.9%	2.5%
ROaE	18.2%	15.4%
Liquidity ratio	41.4%	41.4%

Source: DTB.

The banking sector has been affected by the regulations passed including the cap on interest rates in a number of ways. The number of loan accounts has declined significantly, resulting in rising average loan size, since the introduction of the interest rate capping law. The rising value of loan size vis-à-vis reduced number of loan accounts reflects lower access to smaller borrowers and larger loans to more established firms. There has also been changes in loan sizes among the sectors with the most notable growth being 76.3% in Hotel and Tourism partly attributed to the large number of SMEs in the sector which may have been denied loans after the caps. Personal household loans however reported declining average loan size

Banks have generally increased their investment in government securities., while the share of credit to the private sector has continued to decline. Following the

interest rate caps, banks are shifting the revenue sources to non-interest income and non-interest income has increased gradually to 15.2% of revenue in June 2017 from 12.4% in September 2016 when the interest rate caps commenced. The structure of deposits, as time deposits (interest earning accounts) declined while demand deposits (non-interest earning accounts) increased.

The banks remain adequately capitalised with core and total capital risk-weighted assets averaging 15.8% and 18.7%, which is above the regulatory requirements of 10.5% and 14.5% respectively. Tier 3 banks however have experienced capital erosion as a result of the interest rate caps, as reduced earnings impacted on their ability to build up capital.

The banking sector has seen a decline in profitability in 2017 as a result of the interest rate caps. ROE and ROA have declined to 15.4% and 2.5% in 2017 from 18.2% and 2.9% in 2016 respectively. The asset quality for most banks deteriorated to an industry average NPL ratio of 8.9% from 7.5% in 2016 due to the adverse economic conditions and the introduction of IFRS 9 which requires banks to increase their loan loss provisioning.

Competitive position[4]

The Kenyan banking sector is highly fragmented and competitive, with Tier 1 banks (top eight banks) accounting for 66% of total industry assets, and the rest split among 32 other players at FY17. Key peer analysis indicators for FY17 are provided in Table 4.

Table 4: Peer analysis (KESm)	Barclays	CBA	Equity	DTB
Market shares (%)				
WMSI	6.7	5.6	10.0	6.7
Total assets +	6.8	5.6	10.2	6.7
Advances	7.4	4.5	9.5	6.6
Customer deposits	6.4	6.2	10.3	6.6
Selected ratios (%)				
Capital adequacy	18.0	17.3	16.5	18.5
Gross NPL ratio	5.3	5.7	5.5	6.3
Coverage ratio	59.5	64.5	39.8	66.3
Advance to deposits ratio	90.4	56.9	71.8	78.0
Cost ratio	55.9	46.5	46.7	35.5
ROE	15.6	19.3	28.6	13.8
ROA	2.5	2.6	4.2	2.1

+ Excluding contingencies.
Source: DTB.

By total assets, DTB ranked 5th out of 8 Tier 1 banks at FY17 (FY16: 6th). DTB increased its weighted market share index ("WMSI") share to 6.7% at FY17 (FY16: 6.4%), effectively cementing its position in the Tier 1 bank category. DTB's capitalisation is better than its peers, while it is lagging in profitability and asset quality as compared to its peers.

[4] Banking sector comparatives based on Kenyan operations (excluding regional subsidiaries).

Financial profile

Likelihood of support

The likelihood of support is high as shareholders have demonstrated support for the group, underwriting all capital/fund raising initiatives as evidenced by four previous rights issues (2006, 2007, 2012 and 2014), which were all over-subscribed. The growth of DTB to a Tier 1 bank increases its systemic importance. However, even though the Kenyan government has demonstrated its position as an interventionist, this must be viewed as a systemic protection mechanism only (no history of providing bailouts to distressed banks).

Funding composition

Total liability funding grew by 9.4% to KES303.9bn at FY17 (FY16: 21.5%). A breakdown of the group's funding profile is shown in Table 5.

The group is predominantly funded by customer deposits, which contributed a higher 87.6% (FY16: 85.7%) of the funding base at FY17. Borrowings declined to 5.7% of the funding base at FY17 from 7.9% at FY16. Meanwhile, interbank deposits contributed a slightly higher 6.7% at FY17 (FY16: 6.3%). Customer deposit growth of 11.8% at FY17 benefitted from expansion of branch and agency banking networks but the growth rate was less than the previous years (FY16: 22.7%; FY15: 20.6%), due to the adverse economic conditions in East African countries.

Table 5: Funding base	FY16		FY17	
	KESm	%	KESm	%
Customer deposits	238 104	85.7	266 247	87.6
Current/demand	*70 130*	*25.3*	*88 308*	*29.1*
Savings	*23 427*	*8.4*	*26 201*	*8.6*
Fixed/call	*144 547*	*52.0*	*151 738*	*49.9*
Interbank	17 576	6.3	20 504	6.7
Deposits	*15 367*	*5.5*	*18 785*	*6.2*
Current account	*2 209*	*0.8*	*1 719*	*0.6*
Borrowings*	22 062	7.9	17 175	5.7
Subordinated debt	*7 630*	*2.7*	*6 529*	*2.1*
Senior loans	*6 905*	*2.5*	*6 462*	*2.1*
Trade finance	*7 507*	*2.7*	*4 166*	*1.4*
Administered funds	*20*	*<0.1*	*18*	*<0.1*
Total	**277 741**	**100.0**	**303 926**	**100.0**

Source: DTB.

***Composition of borrowings**

Subordinated loans

(i) DTB has 2 long-term subordinated debt facilities totalling USD40.1m at FY17 (FY16: USD43.3m) raised from the IFC+.
(ii) DTB Tanzania received a subordinated facility of USD5m from the IFC with a tenor of 7 years in June 2014, and an additional 10 year subordinated facility of USD7m from DEG+ in September 2014.
(iii) DTB Uganda received a subordinated debt facility of USD5m from IFC with a tenor of 7 years in August 2014, and an additional 10 year subordinated facility of USD5m from DEG in September 2014.

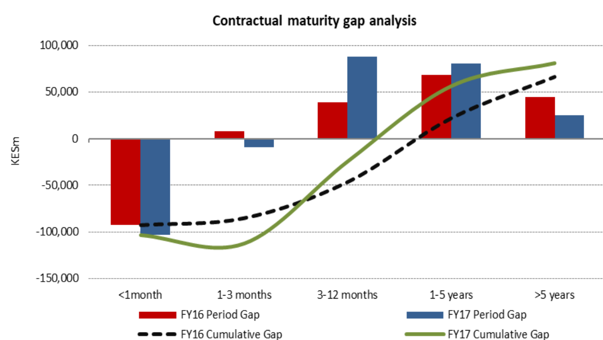
+ International Finance Corporation ("IFC"), Deutsche Investitions- und Entwicklungsgesellschaft ("DEG"), and Agence Francaise De Development ("AFD").

DTB improved its cost of funding by increasing inexpensive current and savings deposits (sourced largely from individuals through the group's branch

and agency networks) to 29.1% and 8.6% of total funding at FY17 (FY16: 25.3% and 8.4%) respectively. The bank has also significantly reduced its borrowings to 5.7% of total funding at FY17 (FY16: 7.9%).

The contractual maturity profile points to a substantial portion of the funding base being transactional/short-term in nature. The deposit base remained fairly diversified, with the single largest and 20 largest depositors constituting 2.1% (FY16: 1.6%) and 14.2% (FY16: 11.8%) of customer deposits respectively at FY17.

Liquidity risk
Like many lending institutions, DTB is subject to short-term asset liability mismatches. In this regard, the group largely displays negative liquidity gaps in the critical 'less than 30 days' maturity bucket equivalent to 1.9x of regulatory capital at FY17 (FY16: 1.9x).



The group manages liquidity risk through internal models and calculations carried out by the Asset and Liability Committee. DTB ensures that there is sufficient liquidity to meet maturing deposit obligations and withdrawals and absorb any short-term or medium-term unplanned cash withdrawals resulting from financial and/or economic stress. Furthermore, the group maintains its liquidity ratio above both the regulatory and board approved minima of 20% and 25% respectively. At FY17, the group saw an improvement in its liquidity position with the ratio of liquid assets/short-term funding at 52.3% (FY16: 48.9%) and the net advances/total funding ratio decreased to 64.5% (FY16: 68.4%).

Capital structure

The group's capitalisation position is shown in Table 6 below. The group's capitalisation metrics improved with its total regulatory capital growing by 12.2% at FY17 (FY16:11.0%), to KES54.6bn supported by retained earnings and acquisition of HBL Kenya. The group's total CAR increased to 23.2% at FY17 (FY16: 20.2%), well above the prevailing regulatory minimum of 14.5% at FY17. DTB's capitalisation provides an adequate buffer against unexpected losses in the short- and medium- term. The adoption of IFRS 9 is expected to increase provisions by between 1% and 2% of current provisions allowing for credit losses under the new impairment requirements.

Table 6: Capitalisation	FY16 KESm	FY17 KESm
Tier 1 capital	41 268	48 148
Tier 2 capital	7 397	6 458
Total regulatory capital	**48 665**	**54 606**
Total risk weighted assets	**240 655**	**234 810**
On-balance sheet	*196 076*	*206 915*
Off-balance sheet	*22 031*	*1 158*
Operational and market risk	*22 548*	*26 736*
Tier 1 capital: RWA	**17.1%**	**20.5%**
Statutory requirement @ 10.5%		
Regulatory capital: RWA	**20.2%**	**23.3%**
Statutory requirement @ 14.5%		

Source: DTB.

The total CAR for the group's banking subsidiaries, which are all above the respective regulatory requirements at FY16, are shown in Table 7.

Table 7: CAR (%)	Regulatory minimum	FY16	FY17
DTB Kenya	14.5	18.5	19.0
DTB Tanzania	14.5	26.2	24.9
DTB Uganda	12.0	23.1	29.9
DTB Burundi	14.5	41.4	62..0

Source: DTB.

Operational profile

Risk management

DTB's risk management framework is based on risk principles approved by the board and underpinned by numerous reporting lines for each of the key risk management divisions.

Credit risk

The most prominent risk affecting the group is credit risk, considering the magnitude of loans and advances and the complexity and subjectivity of judgements the directors need to make concerning both timing of recognition of impairment and the estimation of the magnitude of such impairment. To mitigate credit risk (among other measures), the group only extends loans after underwriting by the Credit Department which is an independent and separate unit from that initiating the credit application and managing the relationship, ensuring independence in the credit risk assessment, repayment capacity and sufficient security in case of default. The group works within board approved risk limits which are reviewed annually.

Asset composition
On-balance sheet assets grew by 10.8% (FY16: 20.8%) to KES363.1bn at FY17. Table 8 provides a breakdown of the group's total on-balance sheet assets (excluding goodwill) at FY17.

Asset growth was mainly reflected in cash and liquid assets, contributing a higher 45.8% of total assets at FY17 (FY16: 39.0%), including government securities (which grew by 21.4%) and interbank placements

(which grew by 64.5%), representing relatively low credit risk. Customer loans remained the dominant risk asset class constituting 59.8% of total assets at FY17.

Table 8: Asset composition*	FY16		FY17	
	KESm	%	KESm	%
Cash and liquid assets	127 770	39.0	150 007	45.8
Cash	*5 904*	*1.8*	*7 632*	*2.3*
Balances with CBK	*21 577*	*6.6*	*17 377*	*5.3*
Government securities†	*92 678*	*28.3*	*112 482*	*34.3*
Balances with banks	*7 611*	*2.3*	*12 516*	*3.8*
Customer loans & advances	186 303	56.8	196 048	59.8
Investment in associates	29	<0.1	35	<0.1
Fixed assets	6 738	2.1	6 716	2.0
Other investments	100	<0.1	71	<0.1
Other assets	6 932	2.1	10 252	3.1
Total	**327 872**	**100.0**	**363 130**	**100.0**

* Excluding goodwill.
† Treasury bills and bonds of KES84.9bn at FY17 issued by the Republic of Kenya (FY16: KES74.5bn) and the remainder by the United Republic of Tanzania, Republic of Uganda and Republique du Burundi.
Source: DTB.

The group's off-balance sheet exposure in the form of letters of credit and guarantees increased by 31.2% in FY17 to KES32.6bn, representing a higher 8.2% of total on- and off-balance sheet assets at FY17 (FY16: 7.1%). GCR notes that these exposures are fully covered, with all credit approval processes carried out on each contingency.

Table 9: Contingencies	FY16		FY17	
	KESm	%	KESm	%
Letters of credit	10 634	42.7	16 115	49.4
Guarantees	14 243	57.3	16 532	50.6
Total	**24 877**	**100.0**	**32 647**	**100.0**

Source: DTB.

Loan portfolio

The challenging operating environment characterised by a higher risk of credit default led to a deliberate slowdown in credit uptake as the group focused on maintaining the quality of current risk assets. Gross loans and advances grew by 6.4% to KES207.1bn at FY17. The implementation of the Banking Act 2016, which established a ceiling on commercial banks' lending rates at 400 basis points above the base rate as set by the CBK whilst capping the minimum deposit rate to 70% of the CBR, also affected loan growth.

Table 10: Gross loans and advances	FY16		FY17	
	KESm	%	KESm	%
Agriculture	8 800	4.6	9 394	4.8
Business and financial	36 258	18.6	30 495	15.7
Construction and real est.	47 779	24.6	51 675	26.6
Individuals	5 912	3.0	8 172	4.2
Manufacturing	23 147	11.9	31 042	16.0
Retail housing	1 012	0.5	724	0.4
Tourism and hotels	15 096	7.8	17 770	9.1
Transport and comm.	16 189	8.3	14 194	7.3
Wholesale and retail	38 212	19.6	41 558	21.4
Other	2 159	1.1	2 078	1.1
Total	**194 564**	**100.0**	**207 103**	**100.0**

Source: DTB.

The sectors with predominant exposures were construction and real estate (26.6%), wholesale and retail (21.4%), manufacturing (16.0%) and financial services (18.6%). The group reduced its concentration risk at FY17 with the single and top 20 exposures accounting for 3.0% and 38.5% (FY16: 4.0% and 43.9%) of the loan portfolio respectively and these were in line with prudential limits.

Asset quality

DTB's key asset quality indicators are shown in Table 11. The group's gross NPLs increased significantly by 115.6% to KES13.1bn at FY17 (FY16: 41.6% increase), which was mainly attributed to economic challenges in East African economies resulting in a cash crunch and reduced investments and reclassification of stressed loans which went into default status during the review period. Consequently, the gross NPL ratio increased to 6.3% at FY17, up from 3.1% at FY16.

Table 11: Asset quality	FY16	FY17
	KESm	KESm
Gross advances	**194 564**	**207 103**
Neither past due nor impaired	*128 120*	*150 028*
Past due but not impaired	*60 391*	*44 024*
Impaired	*6 053*	*13 050*
Less: Provisions	**(8 261)**	**(11 055)**
Identified	*(4 969)*	*(8 234)*
Unidentified	*(3 292)*	*(2 821)*
Net loans and advances	**186 303**	**196 048**
Loan write-offs	20.0	80.7
Loan recoveries	72.0	150.1
Gross NPL ratio (%)	3.1	6.3
Net NPL ratio (%)	0.8	2.5
Net NPLs/Total capital (%)	2.2	9.9
Specific provisions/NPLs (%)	82.1	63.1

Source: DTB.

The group's collateral against its NPL book is considered adequate with a specific provision coverage of 63.1% of NPLs at FY17 (FY16: 82.1%) which is the highest in the market. Loan recoveries increased by 108.4% to KES150.1m in FY17 (FY16: 157.1%) via stringent monitoring (undertaken daily) and debt recovery measures through a well-established debt recovery unit. It is positively noted that the group avoids any exposure to unsecured lending. The adoption of IFRS 9 will increase provisioning levels affecting profitability in the short-medium term. This is not expected to be significant given the high provision levels the bank already holds compared to other players in the industry.

Financial performance and prospects

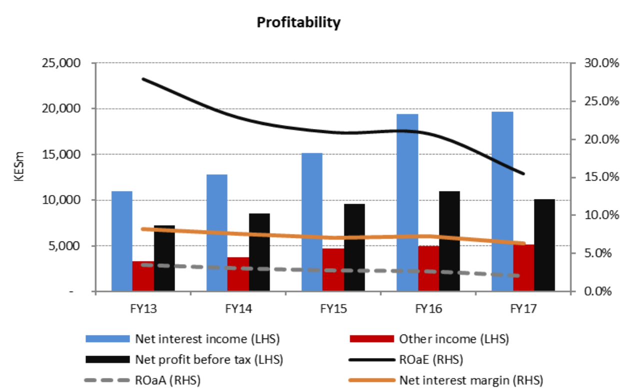
A five year financial synopsis, which forms the basis of the financial performance analysis, is shown on page 8 of this report, supplemented by the commentary below.

The group's profitability decline is reflected in NPBT decreasing by 8.2% to KES10.1bn (FY16: KES11.0bn) as a result of a decline in interest income, an 8.5% decrease in trading income, while operating expenditure grew by 14.8%. Consequently, the group's ROaA and ROaE decreased to 2.0% and 15.5% in FY17 (FY16: 2.6% and 20.6%) respectively.

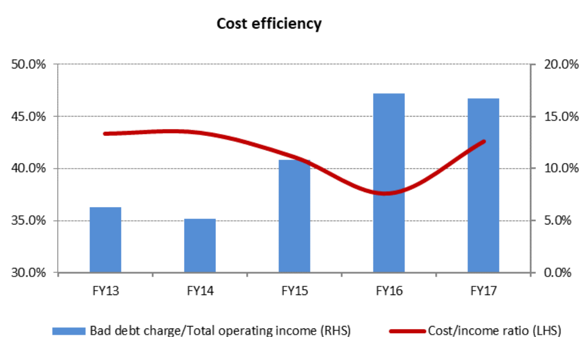
The group's performance for the period can also be stratified by individual business units as shown in Table 12.

Table 12: Earnings split (by business segments)	FY16		FY17	
	KESm	%	KESm	%
Kenya	8 907	81.0	8 285	82.0
Tanzania	1 439	13.1	1 346	13.3
Uganda	1485	4.4	381	3.8
Burundi	164	1.5	86	0.9
Total profit before tax	**10 995**	**100.0**	**10 098**	**100.0**

Source: DTB.



Total operating income grew by 1.7% in FY17 (FY16: 22.6%) as net interest income, also grew by 2.4% FY17 (FY16: 27.6%) as a result of interest rate caps which were implemented and the slow growth in lending as a result of the adverse economic conditions in East African economies. Fee and commission income grew by a lower 1.6% in FY17 (FY16: 11.4%).



Operating expenses grew by a higher 14.8% in FY16 (FY15: 12.5%) mainly due to investments in technology and digital platforms. Consequently, the group's cost ratio increased to 42.6% at FY17 from 37.7% at FY16.

Looking ahead, the DTB Strategy 2030 and Beyond business model which aims to grow its brand as a leading business bank in East Africa by expanding its niche SME customer base, as well as widening its spectrum of customer segments to include the underbanked and with investment in technology and innovation. The group is well positioned to maintain a profitable and conservative business profile. It is anticipated that DTB will continue to benefit from its regional brand/ franchise value and strong shareholder capacity. Adverse economic conditions in East Africa may continue to affect the groups asset quality, although risk is reduced by adequate coverage.

Diamond Trust Bank Kenya Limited

(Kenya Shillings in millions except as noted)

Year end: 31 December	2013	2014	2015	2016	2017
Income Statement Analysis					
Interest income	17,179	20,808	25,825	33,813	34,629
Interest expense	(6,177)	(8,020)	(10,635)	(14,428)	(14,954)
Net interest income	**11,003**	**12,788**	**15,190**	**19,385**	**19,675**
Fee and commission income	2,033	2,318	2,774	3,091	3,141
Trading income	1,224	1,362	1,763	1,746	1,597
Other income	97	102	160	166	396
Total operating income	**14,357**	**16,569**	**19,887**	**24,389**	**24,809**
Impairment charge	(899)	(851)	(2,150)	(4,197)	(4,151)
Operating expenditure	(6,223)	(7,197)	(8,171)	(9,195)	(10,560)
Net profit before tax	**7,235**	**8,521**	**9,565**	**10,996**	**10,098**
Tax	(2,004)	(2,813)	(2,965)	(3,268)	(3,173)
Net profit after tax	**5,231**	**5,708**	**6,600**	**7,728**	**6,925**
Balance Sheet Analysis					
Subscribed capital	4,737	8,263	8,263	8,360	10,125
Reserves (incl. net income for the year)	16,214	20,700	25,871	32,669	38,245
Hybrid capital (incl. eligible portion of subordinated term debt)	2,882	3,637	5,539	5,388	-
Minority interest	2,793	3,300	4,171	4,848	5,250
Less: Goodwill	(173)	(173)	(173)	(173)	(173)
Total capital and reserves	**26,452**	**35,727**	**43,671**	**51,091**	**53,446**
Bank borrowings (incl. deposits, placements & REPOs)	4,718	2,388	8,406	17,576	20,504
Customer deposits	127,154	158,785	192,796	236,197	266,247
Other borrowings	-	-	11,389	7,507	-
Short-term funding (< 1 year)	**131,872**	**161,172**	**212,591**	**261,280**	**286,751**
Bank borrowings (incl. deposits, placements & REPOs)	-	5	-	-	-
Customer deposits	1,634	2,171	1,256	1,906	-
Other borrowings	2,879	8,650	9,214	9,167	17,175
Long-term funding (> 1 year)	**4,513**	**10,826**	**10,469**	**11,074**	**17,175**
Payables/Deferred liabilities	3,509	3,640	4,703	4,426	5,758
Other liabilities	**3,509**	**3,640**	**4,703**	**4,426**	**5,758**
Total capital and liabilities	**166,347**	**211,366**	**271,435**	**327,872**	**363,130**
Cash in hand	3,660	4,210	4,325	5,904	7,632
Balances with central bank	9,049	11,700	22,025	21,577	17,377
Fixed assets	4,879	5,272	5,619	6,738	6,716
Receivables/Deferred assets	3,572	3,712	4,813	6,932	8,454
Non-earnings assets	**21,160**	**24,894**	**36,782**	**41,151**	**40,179**
Loans and advances (net of provisions)	110,945	137,655	177,545	186,303	196,048
Bank placements	8,786	13,701	10,017	7,611	12,516
Marketable/Trading securities	25,446	35,101	46,939	92,678	112,482
Total investments	-	-	128	100	1,816
Investments in associates	10	15	24	29	88
Total earning assets	**145,187**	**186,472**	**234,653**	**286,721**	**322,951**
Total assets	**166,347**	**211,366**	**271,435**	**327,872**	**363,130**
Contingencies	**14,292**	**24,306**	**28,991**	**24,877**	**32,647**
Ratio Analysis (%)					
Capitalisation					
Internal capital generation	25.0	19.7	19.3	18.8	14.3
Total capital / Total assets	15.9	16.9	16.1	15.6	14.7
Liquidity					
Net advances / Customer deposits	86.1	85.5	91.5	78.2	73.6
Net advances / Total funding (excl. equity portion)	81.3	80.0	79.6	68.4	64.5
Liquid and trading assets / Total assets	28.2	30.6	30.7	39.0	40.9
Liquid and trading assets / Total short-term funding	35.5	40.2	39.2	48.9	52.3
Liquid and trading assets / Total funding (excl. equity portion)	34.4	37.6	37.3	46.9	48.9
Asset quality					
Impaired loans / Gross advances	1.1	1.1	2.3	3.1	6.3
Total loan loss reserves / Gross advances	2.8	2.6	2.9	4.2	6.0
Bad debt charge (income statement) / Total operating income	6.3	5.1	10.8	17.2	16.7
Profitability					
Net interest margin	8.2	7.6	7.1	7.3	6.3
Non-interest income / Total operating income	23.4	22.8	23.6	20.5	20.7
Cost ratio	43.3	43.4	41.1	37.7	42.6
ROaE	27.9	22.9	20.9	20.6	15.5
ROaA	3.5	3.0	2.7	2.6	2.0
Nominal growth indicators					
Total assets	23.0	27.1	28.4	20.8	10.8
Net advances	26.5	24.1	29.0	4.9	5.2
Shareholders funds	26.8	38.2	17.9	20.2	17.9
Total capital and reserves	34.0	35.1	22.2	17.0	4.6
Customer deposits	20.4	25.0	20.6	22.7	11.8
Total funding (excl. equity portion)	21.5	26.1	29.7	22.1	11.6
Net income	28.6	9.1	15.6	17.1	(10.4)

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GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S FINANCIAL INSTITUTIONS GLOSSARY

Arm's Length	A transaction in which the parties act independently and have no transaction favourable relationship with each other, or are not subject to undue influence or duress from one another.
Asset Quality	Refers primarily to the credit quality of a bank's earning assets, the bulk of which comprises its loan portfolio, but will also include its investment portfolio as well as off balance sheet items. Quality in this context means the degree to which the loans that the bank has extended are performing (ie, being paid back in accordance with their terms) and the likelihood that they will continue to perform.
Bad Debt	An amount owed by a debtor that is unlikely to be paid due, for example, to a company going into liquidation. There are various technical definitions of what constitutes a bad debt, depending on accounting conventions, regulatory treatment and the individual entity's own provisioning and write-off policies.
Basis Point	1/100th of a percentage point.
Bond	A long term debt instrument issued by either: a company, institution or the government to raise funds.
Capital	The sum of money that is invested to generate proceeds.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its current liabilities and also in relation to the risks associated with its assets. An appropriate level of capital adequacy ensures that the entity has sufficient capital to support its activities and that its net worth is sufficient to absorb adverse changes in the value of its assets without becoming insolvent.
Cash	Funds that can be readily spent or used to meet current obligations.
Collateral	Asset provided to a creditor as security for a loan.
Corporate Governance	Refers to the mechanisms, processes and relations by which corporations are controlled and directed, and is used to ensure the effectiveness, accountability and transparency of an entity to its stakeholders.
Cost Ratio	The ratio of operating expenses to operating income. Used to measures a bank's efficiency.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and/or interest when due.
Customer Deposit	Cash received in exchange for a service, including safekeeping, savings, investment, etc. Customer deposits are a liability in a bank's books.
Default	Failure to meet the payment obligation of either interest or principal on a debt or bond. Technically, a borrower does not default, the initiative comes from the lender who declares that the borrower is in default.
Equity	Equity (or shareholders' funds) is the holding or stake that shareholders have in a company. Equity capital is raised by the issue of new shares or by retaining profit.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding.
Facility	The grant of availability of money at some future date in return for a fee.
Fixed Deposit	Where funds are deposited in a savings account for a pre-determined period of time.
Goodwill	Arises upon the sale/acquisition of a business and is defined as an established entity's reputation, which may be regarded as a quantifiable asset and calculated as the price paid for a company over and above the net value of its assets. Negative goodwill refers to a situation when the price paid for a company is lower than the value of its assets.
Guarantee	An undertaking in writing by one person (the guarantor) given to another, usually a bank (the creditor) to be answerable for the debt of a third person (the debtor) to the creditor, upon default of the debtor.
Impairment	Reduction in the value of an asset because the asset is no longer expected to generate the same benefits, as determined by the company through periodic assessments.
Intangible Assets	The non-physical assets of a company such as trademarks, patents, copyright, information systems and goodwill.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Interest Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
International Financial Reporting Standards	IFRS is designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liabilities	All financial claims, debts or potential losses incurred by an individual or an organisation.
Liquid Assets	Assets, generally of a short term, that can be converted into cash.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Liquidity Risk	The risk that a company may not be able to meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets. Regarding securities, the risk that a financial instrument cannot be traded at its market price due to the size, structure or efficiency of the market.
Long-Term	Not current; ordinarily more than one year.

Long-Term Rating	Reflects an issuer’s ability to meet its financial obligations over the following three to five year period, including interest payments and debt redemptions. This encompasses an evaluation of the organisation’s current financial position, as well as how the position may change in the future with regard to meeting longer term financial obligations.
Margin	The rate taken by the lender over the cost of funds, which effectively represents the entity’s profit and remuneration for taking the risk of the loan; also known as spread.
Market Capitalisation	The total value of a company's shares as quoted on a stock exchange. It is calculated by multiplying the total number of shares in issue by the market price.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Monetary Policy	Measures taken by the central bank to influence the quantity of money or the rate of interest with a view to achieving stable prices, full employment and economic growth.
Moratorium	A period of time in which an activity is suspended until such time as a change in circumstances permits its removal. For example, a borrower can declare a moratorium on the repayments of the principal, and sometimes the interest, on a loan.
Net Interest Margin	Net interest income divided by average interest earning assets. Measures a bank’s margin after paying funding sources and how successful a bank’s interest-related operations are.
Net Profit	Trading/operating profits after deducting the expenses detailed in the profit and loss account (including taxes).
Off Balance Sheet	Off balance sheet items are assets or liabilities that are not shown on a company's balance sheet. They are usually referred to in the notes to a company's accounts.
Past Due	Any note or other time instrument of indebtedness that has not been paid on the due date.
Performing Loan	A loan is said to be performing if the borrower is paying the interest on it on a timely basis.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
Rating Outlook	Indicates the potential direction of a rated entity’s rating over the medium term, typically one to two years. An outlook may be defined as: 'Stable' (nothing to suggest that the rating will change), 'Positive' (the rating symbol may be raised), 'Negative' (the rating symbol may be lowered) or 'Evolving' (the rating symbol may be raised or lowered).
Regulatory Capital	The total of primary, secondary and tertiary capital.
Retained Earnings	Earnings not paid out as dividends by a company. Retained earnings are typically reinvested back into the business and are an important component of shareholders' equity.
Rights Issue	One of the ways that a company can raise additional funds is to issue new shares. These must be first offered to current shareholders and a rights issue allows a shareholder to buy shares in proportion to the number already held.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Risk Management	Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.
Securities	Various instruments used in the capital market to raise funds.
Security	An asset deposited or pledged as a guarantee of the fulfilment of an undertaking or the repayment of a loan, to be forfeited in case of default.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
Short-Term	Current; ordinarily less than one year.
Short-Term Rating	An opinion of an issuer’s ability to meet all financial obligations over the upcoming 12 month period, including interest payments and debt redemptions.
Stock Exchange	A market with a trading-floor or a screen-based system where members buy and sell securities.
Subordinated Debt	Debt that in the event of a default is repaid only after senior obligations have been repaid. It is higher risk than senior debt.
Tenor	The time from the value date until the expiry date of a financial instrument.
Term Deposit	A savings account held for a fixed term. Also called a time deposit. Generally, there are penalties for early withdrawal.
Tier 1 Capital	Primary capital consists of issued ordinary share capital, hybrid debt capital, perpetual preference share capital, retained earnings and reserves. This amount is then reduced by the portion of capital that is allocated to trading activities and other regulatory deductions.
Tier 2 Capital	Secondary capital is mainly made up of subordinated debt, portfolio impairment and 50% of any revaluation reserves and other specified regulatory deductions.

For a detailed glossary of terms please click here

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Diamond Trust Bank Kenya Limited participated in the rating process via face-to-face management meetings, telephone conversations and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit ratings have been disclosed to Diamond Trust Bank Kenya Limited with no contestation of the ratings.

Information received from Diamond Trust Bank Kenya Limited and other reliable third parties to accord the credit ratings included:

- Audited financial results as at 31 December 2017
- Four years of comparative numbers
- Unaudited interim results at 31 March 2018
- Budgeted financial statements for 2018
- Corporate governance and enterprise risk framework

The ratings above were solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the ratings.

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