



Equity Research | Diamond Bank Plc

ARM Research

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Full Year Earnings Report

12 months ended 31<sup>st</sup> December, 2012

**Recommendation: BUY**

- Diamond Bank reported 27% YoY growth in turnover to N136bn for the 12 months to December 2012. PBT and PAT came in at N27.5bn and N22.1bn compared to respective losses of N18bn and N13.9bn in FY 2011.
- Gross earnings were 6% below our estimates while PBT was 9% behind on slightly higher opex and weaker non-interest income. However, PAT was 5% ahead due to a 10ppt discrepancy in effective tax rates.

***Revenue growth falters as NIR falls short on derivative losses***

- Diamond's gross earnings contracted 26% QoQ to N26.6bn breaking an 8-quarter rising trend. Non-interest revenue (NIR) which fell 70% QoQ and was 73% short of our estimates was primarily responsible for the weakness in the top-line as Diamond reported a N5.6bn loss on derivative instruments in Q4 12, worsened by a N1.2bn loss in the trading income line—in contrast to the broad trend of trading gains in FY 12 results. Thus, while fee income (+65% QoQ) and other operating income items showed expected growth, the overall rising NIR trend in 2012 was halted largely due to the derivative losses which accounted for 82% of the Q4 shortfall in NIR relative to our estimates. Interest income (-34% QoQ to N24bn) also decelerated more rapidly than we estimated (-27% QoQ) owing to 11.8% asset yields being 40bps below our estimate.

**Income Statement Data**

	2012- FY 'm	2011 - FY 'm	%chg
Revenue	136,091	106,774	27%
PBT	27,482	(17,965)	N/A
Tax	(5,373)	4,024	N/A
PAT	22,108	(13,941)	N/A

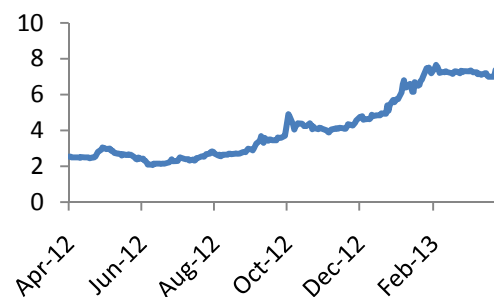
**Balance Sheet Data**

	2012-Dec 'm	2011 -Dec 'm	%chg
Cash	132,196	55,784	137%
Loans	585,200	339,266	72%
Deposits	910,234	601,695	51%
Fixed Asset	44,980	38,613	16%
Net Assets	108,856	93,330	17%

**Stock Data**

Price	N6.30
52 week range	N2.07– N7.66
Market Cap. (N'm)	91,194.04
1-month Avg. Vol	13,187,997
Curr. PE	4.1x
Bloomberg Ticker	DIAMONDB NL
Reuters Ticker	DIAMONB.LG

**Diamond Plc - Share Price Trend**



**Analyst(s)**

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### ***Higher costs drive Q4 operational loss***

- Interest expense rose 17% QoQ in line with a similar magnitude rise in funding base and reflects Diamond's continued ability to mobilize deposits in a cost-effective manner. The rise in deposits to N901bn was faster than we envisaged (FY12E N806bn), nevertheless interest expense still fell 24% short of our forecasts. It would appear that the industry –wide competition for funds we anticipated on expected proliferation of essentially the same structure as Diamond's Savings Xtra platform, which has been Diamond's primary vehicle for raising cheap deposits, did not have as adverse an impact as envisaged. Consequently, FY 2012 WACF moderated 20bps from 9M to 2.3% versus our expectation for a 30bps rise to 2.8%.
- Operating expenses surged 23% QoQ to N21.7bn, driven by personnel expenses which rose 35% QoQ while other operating expense items jointly declined 3% QoQ. Opex was 13% ahead of our estimates.
- The jumps in interest expense and opex amid lower revenues drove a N2.1 bn operating loss for Q4 12 (CIR: 111%) and bumped up FY CIR 11ppt from 9M levels to 61% (FY12E 55%).

### ***Write-backs mark a turnaround in provisioning***

- Halting 11 straight quarters of substantial provisioning, Diamond booked a N6.4bn write-back in Q4 12. Whilst management reports NPL ratio halved YoY to 4.7%, we note that this is largely a result of rapid growth in loans (+72% YoY) as actual NPLs declined a more moderate 27% YoY to N29bn. We thus believe the charge likely reflects strong recovery on a single exposure as opposed to broad based progress in resolving legacy issues.
  - Nevertheless, the write-back compensated for the operating loss and helped Diamond book N4.3bn PBT (39% below our estimates) while PAT of N3.9bn was 33% ahead of our estimates which incorporated a 30% FY212E tax rate (in line with 9M average) vs 20% actual. PBT and PAT margins of 16% and 15% were respectively 400bps and 100bps below their 9M averages but still represent significant improvement on the 57% and 38% loss margins in FY 2011.
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### ***Longer term optimism supported by capital raising plans***

- The absence of a dividend from Diamond (the only bank not to announce a FY dividend thus far) is in line with our expectations (0% payout ratio) which had been hinged on the need to conserve as much capital as necessary after the spate of provisions. Whilst Diamond's FY CAR of 17% is an improvement on H1 level of 12%, the announcement of a \$750million (~N120bn) capital raise underscores the need to replace lost reserves as well as an ambitious growth drive with loans rising 72% YoY (vs initial guidance of 40%). Furthermore, whilst details are as yet pending, the switch to IFRS and impending industry-wide Basel II adoption indicate there could be a significant Tier I capital component compared to a focus on dollar-based tier II capital as at H1 12. We believe this development could be significant for sustaining growth as from 2014.
  - Based on modest asset yield deviation of 40bps below our estimate (the smallest of banks which have released with average downside of 105bps) we believe its retail asset segments provided the expected support to Diamond's yields. However, in cognizance of further yield declines, we have adopted a 50bps cut in 2013 asset yields although we have simultaneously increased our earning asset volumes in line with faster deposit growth than envisaged. Furthermore, we note weak interest Q4 NIR was exceptional and expect growth to resume in 2013 driven by fee income. We estimate Q1 2013 revenues rose 54% over a weak Q4 12 to N41bn with an overall forecast of N164bn for FY 13E.
  - We expect the improvements in Diamond's funding costs to be sustained especially as the introduction of similar deposit generation schemes by some of its competitors has had little apparent effect on the success of its Savings Xtra product. Thus, we expect flat interest expense QoQ at ~N7bn with FY 2013 net interest margins steady at 80%, 300bps higher than previous.
  - We have revised our CIR estimates 300bps higher to 58% to match the midpoint between our previous estimates and FY12 results, reflecting our belief that the Q4 jump could be a one-off. Notably, 9month CIR had been 500bps below our FY estimate before being skewed higher by a spike in Q4 13 opex. Accordingly, our Q1 13 opex is 8% lower QoQ in spite of upward revisions to ~N20bn.
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- We have broadly discounted the Q4 write-back pending stronger confirmation that legacy issues are being fully resolved. In our view, the one positive quarter on this front does not outweigh recent history and we have maintained our cost of risk estimate at 2% for FY 2013.
  - Our revisions have been relatively mild with FY 13E PBT flat from previous at N40bn while PAT is 5% higher, reflecting a cut in our tax rate to 20% and translates into EPS of N2.20.

***Not overly swayed by one weak quarter, we maintain BUY rating***

- In spite of the weak Q4, we remain positive on Diamond's ability to sustain improvements in profitability driven by consistently low cost of funds. Our FY 2013 PBT and PAT estimates still imply 46% and 45% respective YoY growth. Reflecting cut back in discount rates and expectations for ~300bps higher PAT margins over our forecast horizon from current levels, our fair value estimate has increased 18% to **N10.1**. Diamond also trades at current PE of 4.1x and P/Bv of 0.9x compared to peer averages of 8.8x and 1.4x respectively while its forward PE of 3x compares with peer average of 6.6x. Coupling these valuation discounts with the 59% upside implied to our fair value estimate, we maintain a **BUY** rating on the stock.
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## Summary of Forecasts

Quarterly					
Income Statement (N'm)	Q1 2013E	Q2 2013E	Q3 2013E	Q4 2013E	
Net interest income	26,223	26,091	26,444	27,735	
Non-interest income	7,806	7,650	7,666	8,103	
<b>Total Revenue</b>	<b>34,029</b>	<b>33,741</b>	<b>34,110</b>	<b>35,838</b>	
Total Operating Costs	(19,969)	(19,570)	(19,610)	(20,728)	
<b>Operating Profit</b>	<b>14,060</b>	<b>14,171</b>	<b>14,500</b>	<b>15,110</b>	
Impairment Charge	(4,427)	(4,339)	(4,348)	(4,596)	
<b>Pre-tax Profit</b>	<b>9,633</b>	<b>9,832</b>	<b>10,152</b>	<b>10,514</b>	
Tax	(2,007)	(1,966)	(1,970)	(2,083)	
<b>Post-tax Profit</b>	<b>7,626</b>	<b>7,866</b>	<b>8,182</b>	<b>8,431</b>	
Annual					
Income Statement (N'm)	2011A	2012A	2013E	2014E	2015E
Net interest income	55,650	89,322	106,493	119,433	125,528
Non-interest income	27,793	23,739	31,225	43,537	47,312
<b>Total Revenue</b>	<b>83,443</b>	<b>113,060</b>	<b>137,718</b>	<b>162,971</b>	<b>172,840</b>
Total Operating Costs	- 55,579	- 68,548	- 79,876	- 97,254	- 106,125
<b>Operating Profit</b>	<b>27,864</b>	<b>44,512</b>	<b>57,841</b>	<b>65,716</b>	<b>66,716</b>
Impairment Charge	- 44,148	- 17,028	- 17,710	- 9,872	- 17,264
<b>Pre-tax Profit</b>	<b>- 16,261</b>	<b>27,482</b>	<b>40,132</b>	<b>55,845</b>	<b>49,452</b>
Tax	5,006	- 5,373	- 8,026	- 13,961	- 9,890
<b>Post-tax Profit</b>	<b>- 11,255</b>	<b>22,108</b>	<b>32,105</b>	<b>41,884</b>	<b>39,561</b>
Balance Sheet (N'm)	2011A	2012A	2013E	2014E	2015E
Assets					
Cash & Short term funds	150,372	222,307	196,251	242,340	238,214
Due from banks	145,282	139,803	156,027	208,885	249,280
Net Loans	346,266	585,200	703,265	779,200	875,111
Fixed Assets	38,613	44,980	49,824	60,988	87,585
Other Assets	123,170	185,813	196,673	205,835	224,016
<b>Total Asset</b>	<b>803,703</b>	<b>1,178,104</b>	<b>1,302,040</b>	<b>1,497,248</b>	<b>1,674,207</b>
Liabilities					
Deposits	601,695	910,234	976,757	1,113,143	1,215,433
Due to banks	-	31,207	25,643	13,411	25,045
Borrowings	-	69,434	76,928	88,515	92,815
Other liabilities	108,678	58,373	86,253	126,067	139,959
<b>Total liabilities</b>	<b>710,373</b>	<b>1,069,248</b>	<b>1,165,581</b>	<b>1,341,136</b>	<b>1,473,252</b>
<b>Shareholders' fund</b>	<b>93,330</b>	<b>108,856</b>	<b>136,459</b>	<b>156,112</b>	<b>200,955</b>
Key Data					
EPS (Adj)	(0.78)	1.53	2.22	2.89	2.73
DPS	1.61	-	-	0.43	0.95
BVPS	6.45	7.52	9.43	10.78	13.88
ROE	-12%	20%	24%	27%	20%
ROA	-1.4%	1.9%	2.5%	2.8%	2.4%
Key Ratios					
Loan to Asset	42%	50%	50%	51%	52%
Cost to income	67%	61%	58%	60%	61%
Net Profit Margin	-12%	16%	19%	21%	18%
Liquidity ratio	49%	38%	35%	40%	39%
Capital adequacy ratio	15%	17%	16%	17%	17%

Source: Company financials, ARM Estimates

### ARM ratings and recommendations

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6 month period (minimum) to the review date. We adopt a 5 point rating system for this category of stocks and a 3 point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
BUY	>20%	BUY	>20%
OVERWEIGHT	10% — 20 %	NEUTRAL	5% — 20 %
NEUTRAL	0% — 10 %	SELL	<5%
UNDERWEIGHT	-5% — 0%		
SELL	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject to reasonable portfolio constraints
UNDERWEIGHT	Minimise exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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