

Price	₦1.44
FVE (last communicated)	₦1.39
52-week range	₦0.97 – ₦3.73
Market Cap. (₦mn)	33,351
1-month Avg. Vol	5,966,828
Curr. P/B	0.15x

DIAMONDBNK:NL - Share Price Trend



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Diamond Bank Plc. (DIAMONDBNK.NL)

Initial View

Underlying pressures persist

- Diamond Bank PLC (DIAMONDBNK) released unaudited nine-month 2018 result alongside restated figures for nine-month 2017 following divestment from its West African business operation. The result was unimpressive with the bank struggling to make profit in Q3 standalone.
- Last week, the bank announced the resignation of four of its directors, a move which looked like an imminent investment in the bank from new investors. But, the bank later announced it is not in talk with any party for capital injection. The bank currently has capital issues with its CAR printing slightly above the minimum regulatory requirement.
- **Underlying pressures persist.** Over 9M 18, Diamond Bank reported 35.8% YoY decline in EPS to ₦0.11, largely underpinned by funding costs pressure (17.4% YoY to ₦40.9 billion), which more than outweighed higher non-interest revenue (+10.9% YoY to ₦27.7 billion) and gains from lower impairment charge (-24.2% YoY to ₦25.2 billion). On net interest income, despite expansion in assets yield by 227bps YoY to 10.5% – largely due to 24% YoY decline in interest earning assets coming from the discontinued operation – interest income came in lower by 4% YoY to ₦108 billion. This alongside an increase in interest expense (17.4% YoY to ₦40.9 billion), resulted to a decline in Net Interest Income (-13.7% YoY to ₦67.1 billion). In line with the performance over 9M 18, we are now more doubtful of management's guidance of ₦6.0 billion PBT for FY 18.

- Lower impairment saves Q3 earnings.** Focusing on Q3 figures, we had expected the bank to post a loss in Q3 on the back of higher impairment charge following quarterly trend. In fact, the bank had guided to a loan-loss provision of between ₦40 billion – ₦45 billion for FY 18. The bank however recorded a 33% QoQ decline in loan-loss provisioning (₦6.8 billion) with Cost of Risk moderating 176bps QoQ to 3.6%. 9M 18 loan-loss provision (₦25.2 billion) is now about 63% of management's lower guidance of ₦40 billion for FY 18. Also, the bank recorded a lower funding cost over the period. Nonetheless, the bank still struggled to post a profit of ₦130 million (-91% QoQ) mirroring pressure on both net funding income and NIR.
- NIMs cut back by lower asset yield.** Akin to most banks that have released nine-month results, Diamond Bank recorded moderation in asset yield (-86 bps QoQ to 9.7%) over Q3. The decline in asset yield over the quarter reflected lower interest income from both loans and investment securities on the back of flat growth in the bank's loan book (+0.4% QoQ) and contraction in investment securities (-7.6% QoQ). On the funding leg, contrary to 9M 18 trend, the bank recorded an improvement on its funding cost (-33 bps QoQ to 3.9%) over Q3 mirroring a moderation in borrowing costs. Whilst we think the lower interest paid on its borrowings over Q3 is now reflecting the pay-down of its \$175 million borrowing from Afrexim that matured in May 2018, we are stunned at the decline in the interest paid on its long-term borrowings given its quarterly trend of paying higher interest in Q3 relative to Q1 and Q2 and also the fact that there was no maturity. On balance, NIM (-90 bps QoQ to 7.9%) still treaded lower due to the lower asset yield.
- Lower trading income leaves NIR weak.** As mentioned earlier, weak NIR (-21.1% QoQ to ₦8.6 billion) in the quarter put pressure on earnings. Precisely, the lower NIR over the period reflected lower FX trading income (-57.5% QoQ to ₦569 million) and lower income on financial assets held for trading (-71.2% QoQ to ₦476 million). Overall, despite lower funding cost and impairment charge, the net impact of weak NIR and lower interest income drove PBT 90.1% QoQ lower to ₦164.8 billion with EPS printing at ₦0.01 (-90.7% QoQ).
- Diamond bank in dire need of capital.** The bank's capital adequacy ratio (CAR) currently prints at 16.3% and it's slightly above the regulatory requirement of 15%. Earlier in 2016, the bank almost saw its CAR fall below the minimum regulatory requirement, printing at 15.01%. This however increased to 16.74% by FY 17 largely on the back of divestment from its West African business which saw the removal of deduction on investment and lending to subsidiaries². Supporting the increase in its CAR was also a decline in Risk Weighted Asset (RWA), albeit, growth in core regulatory capital was however flat.

² This deduction amounted to ₦1 billion in 2017 from ₦9.4 billion in 2016

- Although improving, asset quality issues still persist with the bank's NPL ratio standing at 12.6% as at 9M 2018 (FY 17: 14.7%). The bank has a large exposure to the power sector and oil & gas, both of which accounts for 57% (FY 17: 73%) of total NPL and 61%³ of loan book.
- **Funding base.** On its funding base, total deposits and borrowings declined by 8% and 18.5% YTD to ₦1.1 trillion and ₦189 billion respectively. Over H1 2019, we expect maturity of a large proportion of the bank's borrowings, this includes a \$200 million Eurobond the bank issued in May 2014 as well as an IFC convertible bond of \$70 million which is due to mature in July 2019. For the latter, the bank is planning on paying it off while repayment of the Eurobond would depend on the volume of FX liquidity the bank gets from its customers⁴.
- Last week, the bank announced the resignation of four of its directors which included the Chairman of the Board of Directors, Seyi Bickerseth who was appointed earlier this year. The reason alluded to the resignation was on the back of varied personal reasons of the Directors. All four directors except Rotimi Oyekanmi were appointed in July 2017 and none of them was appointed with any link or representative to the major shareholders which includes Kunoch Limited, GDR Holding and CSSAF DBN Holding. Hence, this move looked like there was an imminent capital injection from new investors, which would pave the way for the new investors to nominate new directors to represent them. However, shortly after the announcement, the bank announced it is not in talk with any party for capital injection into the bank.
- Nonetheless, for the bank to drive growth, we believe the bank needs to shore up its capital base. The options available are:
 - **Switching from its international banking license to a national banking license.** This looks more plausible with the sale of its business operation in West Africa and also that of the UK which is expected to be completed by the end of the year.
 - **Raising equity capital.** Following its recent announcement, the bank just annulled the idea of injecting new equity capital.
 - **Raising debt.** We believe refinancing the maturing Eurobond wouldn't be a wild thought and this could possibly occur with the bank issuing more than what is expected to mature similar to Fidelity Bank.

³ Oil & Gas makes up 50% and the midstream accounts for the larger portion

⁴ Mostly oil & gas

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- That said, we will be seeking clarity from management concerning key issues spanning across the lower loan-loss provision, plans on creating risk assets in 2019, expectation of lower NPL, the bank's FX position.
 - The stock is trading at a P/B of 0.15x, a discount to Fidelity (0.33x) and FCMB (0.17x). Our last communicated FVE on Diamond Bank is ₦1.39 which translates to a **SELL** rating on the stock.
 - We will revisit our numbers after further analysis and discussion with management.
 - The bank will be holding a teleconference call on Monday, November 5, 2018 at 3pm Lagos Time (2pm London/ 4pm Johannesburg/ 10am New York) with its senior management. Click [here](#) for details.

Summary of Results and Forecast

₹'million	9M 2018	9M 2017	YoY (pps)	% of FY 18E	Q3 18	Q2 18	QoQ
Gross Earnings	135,725	137,529	-1.3%	73.5%	41,676	47,790	-12.8%
Net Interest Income	67,060	77,667	-13.7%	73.4%	20,579	23,081	-10.8%
Non-Interest Revenue	27,727	24,995	10.9%	71.1%	8,645	10,957	-21.1%
Operating Expenses	(66,530)	(64,668)	2.9%	76.5%	(22,278)	(22,185)	0.4%
Impairment	(25,173)	(33,213)	-24.2%	54.5%	(6,782)	(10,186)	-33.4%
PBT	3,085	4,781	-35.5%	-106.8%	165	1,667	-90.1%
PAT	2,580	4,021	-35.8%	-99.3%	130	1,398	-90.7%
EPS	0.11	0.17	-35.8%		0.01	0.06	
₹'million	Q3 2018	Q2 2018	QoQ				
Loans	730,255	727,694	0.4%				
Total Assets	1,554,928	1,587,741	-2.1%				
Deposits	1,068,180	1,104,480	-3.3%				
Total Liabilities	1,337,833	1,384,034	-3.3%				
Net Assets	217,095	203,707	6.6%				
BVPS	9.37	8.80	6.6%				
	9M 2018	9M 2017	change (pps)		Q3 18	Q2 18	change (pps)
Assets Yields	10.5%	8.2%	2.3		9.7%	10.6%	(0.9)
WACF	4.3%	2.8%	1.5		3.9%	4.2%	(0.3)
Net Interest Margin	6.5%	5.7%	0.8		7.9%	8.8%	(0.9)
Cost-Income Ratio	70.2%	63.0%	7.2		76.2%	65.2%	11.1
Cost of Risk	4.6%	4.5%	0.1		3.6%	5.4%	(1.8)
ROE	1.6%	2.3%	(0.7)		0.3%	2.9%	(2.7)
CAR	16.3%	15.8%	0.5				

Source: Company Financials, ARM Research

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
STRONG 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	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio
RESTRICTED	In certain circumstances, Asset & Resource Management ("ARM") Group policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of ARM Securities' and/or ARM Group's engagement in an investment banking transaction and in certain other circumstances.

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