Cytonn INVESTMENTS

Diamond Trust Bank of Kenya - H1'2021

27th August 2021

Below is a summary of DTB-K H1'2021 performance;

Balance Sheet (Kshs bn)	H1'2020	H1'2021	y/y change
Government Securities	132.5	158.6	19.7%
Net Loans and Advances	201.5	204.3	1.4%
Total Assets	**388.3**	**429.6**	**10.6%**
Customer Deposits	280.4	313.8	11.9%
Total Liabilities	321.1	357.4	11.3%
Shareholders' Funds	**61.0**	**65.4**	**7.1%**

Balance sheet ratios	H1'2020	H1'2021	% point change
Loan to Deposit Ratio	71.9%	65.1%	(6.7%)
Return on average equity	9.8%	6.4%	(3.3%)
Return on average assets	1.5%	1.0%	(0.5%)

Income Statement (Kshs bn)	H1'2020	H1'2021	y/y change
Net Interest Income	9.3	9.8	5.7%
Net non-Interest Income	3.2	3.3	5.5%
Total Operating income	**12.4**	**13.1**	**5.6%**
Loan Loss provision	1.9	2.3	23.9%
Total Operating expenses	**8.0**	**8.3**	**3.7%**
Profit before tax	**4.5**	**4.9**	**8.8%**
Profit after tax	**2.6**	**3.2**	**20.1%**
Core EPS	**9.4**	**11.3**	**20.1%**

Income Statement Ratios	H1'2020	H1'2021	% point change
Yield from interest-earning assets	9.7%	8.9%	(0.8%)
Cost of funding	4.4%	4.0%	(0.3%)
Net Interest Spread	5.3%	4.8%	(0.5%)
Net Interest Income as % of operating income	74.7%	74.7%	0.0%
Non-Funded Income as a % of operating income	25.3%	25.3%	(0.0%)
Cost to Income Ratio (CIR)	64.1%	62.9%	(1.2%)
CIR without provisions	49.1%	45.3%	(3.8%)
Cost to Assets	3.9%	4.9%	1.0%
Net Interest Margin	5.6%	5.2%	(0.4%)

Capital Adequacy Ratios	H1'2020	H1'2021
Core Capital/Total Liabilities	23.4%	22.5%
Minimum Statutory ratio	8.0%	8.0%
Excess	15.4%	14.5%
Core Capital/Total Risk Weighted Assets	19.3%	21.3%
Minimum Statutory ratio	10.5%	10.5%
Excess	8.8%	10.8%
Total Capital/Total Risk Weighted Assets	21.0%	22.8%
Minimum Statutory ratio	14.5%	14.5%
Excess	6.5%	8.3%
Liquidity Ratio	54.4%	60.3%
Minimum Statutory ratio	20.0%	20.0%

Excess	**34.4%**	**40.3%**
Adjusted Core Capital/Total Liabilities	**24.2%**	**22.9%**
Adjusted Core Capital/Total RWA	**19.7%**	**21.7%**
Adjusted Total Capital/Total RWA	**21.4%**	**23.2%**

Key Highlights H1'2021

- In H1'2021, DTB-K committed Kshs 100.0 mn towards cushioning Kenya against the adverse effects of the pandemic where Kshs 50.0 mn was directed to the National COVID-19 Emergency Response Fund while the other Kshs 50.0 mn was directed towards initiatives to support vulnerable Kenyans. Additionally, DTB-K is also part of the Credit Guarantee Scheme through which it is now able to disburse affordable loans faster, lend more and take on riskier SME borrowers.

Income Statement

- The bank's core earnings per share increased by 20.1% to Kshs 11.3, from Kshs 9.4 in H1'2020, lower than our expectations of a 25.7% increase to Kshs 11.8. The growth was driven by the 5.6% increase in total operating income, which outpaced the 3.7% increase in total operating expenses to Kshs 8.3 bn from Kshs 8.0 bn in H1'2020. The variance in the core earnings per share increase against our expectation was mainly attributable to the slower 5.7% increase in Net-Interest Income (NII) to Kshs 9.8 bn, from Kshs 9.3 bn recorded in H1'2020, against our expectations of a 9.4% increase to Kshs 10.2 bn in H1'2021,
- Total operating income increased by 5.6% to Kshs 13.1 bn, from Kshs 12.4 bn in H1'2020 mainly driven by a 5.7% increase in the Net Interest Income (NII) to Kshs 9.8 bn, from Kshs 9.3 bn in H1'2020, coupled with a 5.5% increase in Non-Funded Income (NFI) to Kshs 3.3 bn, from Kshs 3.2 bn in H1'2020,
- Interest income increased by 5.7% to Kshs 16.7 bn, from Kshs 15.8 bn in H1'2020 driven by a 16.8% increase in interest income from government securities to Kshs 7.2 bn from Kshs 6.2 bn in H1'2020 coupled with a 25.6% increase in Interest income from deposit placements to Kshs 75.4 mn, from Kshs 60.0 mn in H1'2020. The increase was however weighed down by a 1.6% decline in interest income from loans and advances to Kshs 9.4 bn, from Kshs 9.6 bn in H1'2020. The Yield on Interest-Earning Assets declined to 8.9% from 9.7% in H1'2020, attributable to a 1.0% decline in trailing interest income, coupled with an 8.2% increase in average interest-earning assets to Kshs 360.9 bn, from Kshs 333.5 bn in H1'2020,
- Interest expense rose by 5.7% to Kshs 6.9 bn, from Kshs 6.5 bn in H1'2020, following a 9.3% increase in interest expense on customer deposits to Kshs 6.1 bn, from Kshs 5.6 bn in H1'2020. The increase was however mitigated by a 35.2% decline in interest expense on placement liabilities to Kshs 231.4 mn, from Kshs 357.0 mn in H1'2020, coupled with a 3.8% decline in other interest expenses to Kshs 572.3 mn, from Kshs 595.0 mn in H1'2020. Cost of funds declined by 0.4% points to 4.0% from 4.4% in H1'2020, owing to the 0.9% decline in trailing interest expenses, coupled with a 7.2% growth in average interest-bearing liabilities, an indication that the bank was able to mobilize cheaper deposits. Net Interest Margin (NIM) declined to 5.2%, from 5.6% in H1'2020 attributable to the 1.0% decrease in trailing interest income coupled with an 8.2% growth in average interest-earning assets,
- Non-Funded Income (NFI) rose by 5.5% to Kshs 3.3 bn, from Kshs 3.2 bn in H1'2020. The increase was mainly driven by the 13.1% increase in other fees and commissions on loans to Kshs 1.0 bn, from Kshs 0.9 bn recorded in H1'2020. The increase in NFI was however weighed down by a 13.2% decline in fees and commissions on loans to Kshs 0.6 bn from Kshs 0.7 bn coupled with a 4.8% decline in foreign exchange trading income to Kshs 1.2 bn, from Kshs 1.3 bn in H1'2020. Notably, total fees and commissions declined by 0.9% to Kshs 1.61 bn, from Kshs 1.60 bn. The revenue mix remained 75:25 funded to non-funded income, owing to the 5.7% growth in NII as compared to the 5.5% in NFI,
- Total operating expenses rose by 3.7% to Kshs 8.3 bn, from Kshs 8.0 bn in H1'2020, largely driven by the 23.9% increase in Loan Loss Provisions (LLP) to Kshs 2.3 bn, from Kshs 1.9 bn in H1'2020. Similarly, Staff costs increased by 2.1% to Kshs 2.42 bn from Kshs 2.37 bn in H1'2020,

- Cost to Income Ratio (CIR) improved to 62.9%, from 64.1% in H1'2020 owing to the 5.6% increase in operating income to Kshs 13.1 bn, from Kshs 12.4 bn in H1'2020, which outpaced the 3.7% increase in operating expenses to Kshs 8.3 bn, from Kshs 8.0 bn in H1'2020. Similarly, cost to income ratio without LLP, improved to 45.3%, from 49.1% in H1'2020, highlighting improved efficiency levels, and,
- Profit before tax increased by 8.8% to Kshs 4.9 bn, from Kshs 4.5 bn in H1'2020. Profit after tax increased by 20.1% to Kshs 3.2 bn in H1'2021, from Kshs 2.6 bn recorded in H1'2020, with the effective tax rate declining to 35.4%, from 41.5% in H1'2020.

Balance Sheet

- The balance sheet recorded an expansion as Total Assets increased by 10.6% to Kshs 429.6 bn, from Kshs 388.3 bn recorded in H1'2020. This growth was largely driven by a 19.7% increase in government securities to Kshs 158.6 bn, from Kshs 132.5 bn in H1'2020, coupled with a 1.4% growth in net loans to Kshs 204.3 bn, from Kshs 201.5 bn in H1'2020,
- Total liabilities grew by 11.3% to Kshs 357.4 bn, from Kshs 321.1 bn in H1'2020, driven by a 22.8% increase in borrowings to Kshs 20.9 bn, from Kshs 17.1 bn in H1'2020, following the additional debts the bank acquired to finance its operations and boost liquidity in H1'2021, coupled with an 11.9% increase in customer deposits to Kshs 313.8 bn from Kshs 280.4 bn in H1'2020. Deposits per branch increased by 11.9% to Kshs 2.3 bn from Kshs 2.1 bn, as the number of branches remained unchanged at 134 in H1'2021,
- Loans to deposit ratio declined to 65.1%, from 71.9% in H1'2020, owing to the faster 11.9% growth in deposits, compared to the 1.4% growth in the net loans during the period,
- Gross Non-Performing Loans (NPLs) rose by 26.6% to Kshs 22.2 bn in H1'2021, from Kshs 17.5 bn recorded in H1'2020. Consequently, the NPL ratio rose to 10.4% from 8.3% recorded in H1'2020, due to the faster 26.6% growth in gross NPLs which outpaced the 1.4% growth in gross loans,
- General Loan Loss Provisions increased by 41.0% to Kshs 8.7 bn from Kshs 6.2 bn in H1'2020. On the other hand, the NPL coverage (having added interest in suspense) decreased to 41.8% in H1'2021, from 51.2% in H1'2020, owing to the 79.9% decline in interest in suspense,
- Shareholders' funds increased by 7.1% to Kshs 65.4 bn in H1'2021, from Kshs 61.0 bn largely due to the 10.0% increase in the retained earnings to Kshs 54.4 bn, from Kshs 49.4 bn in H1'2020,
- Diamond Trust Bank is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 21.3%, 10.8% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 22.8%, exceeding the 14.5% statutory requirement by 8.3% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 21.7%, while total capital to risk-weighted assets came in at 23.2%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.0%, and a Return on Average Equity (ROaE) of 6.4%.

Key Take-Outs:

1. **Asset Quality** - The bank's asset quality deteriorated, with the NPL ratio increasing to 10.4% in H1'2021, from 8.3% in H1'2020, due to the faster 26.6% growth in gross NPLs which outpaced the 1.4% growth in gross loans. The NPL ratio has been deteriorating since the onset of the COVID-19 pandemic attributable to the faster growth in gross NPLs as opposed to the growth in gross loans. The growth in gross NPLs can be attributed to the effects of the pandemic on the economy given that the bank lends mostly to the tourism and real estate sectors which were hardest hit. Net loans increased by 1.4% to Kshs 204.3 bn, from Kshs 201.5 bn in H1'2020. The subdued growth in the loan book is as a result of the bank's continuous selective lending to minimize additional erosion of the asset quality, and,
2. There was an improvement in efficiency levels as the cost to income ratio improved to 62.9% from 64.1% in H1'2020. Similarly, Cost to income ratio without LLP improved to 45.3% from 49.1% in H1'2020, an indication of improving efficiency.

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

I. **Minimized Costs –** DTB-K plans on minimizing the cost of funding in the coming years and tightly controlling overheads with a gradual decline in cost to income ratio through several ways including closing branches that are close to each other. Currently, the bank has merged four branches and is set to merge two more by 30th October 2021.

Valuation Summary

- We are of the view that Diamond Trust Bank Kenya is a **“HOLD”** with a target price of Kshs 71.4, representing an upside of 9.5%, from the current price of Kshs 65.3 as of 27th August 2021,
- Diamond Trust Bank Kenya is currently trading at a P/TBV of 0.3x and a P/E of 4.5x vs an industry average of 0.6x and 7.6x, respectively.