Diamond Trust Bank of Kenya - Q1'2021

28th May 2021

Below is a summary of DTB-K Q1'2021 performance;

Balance Sheet (bns)	Q1'2020	Q1'2021	y/y change
Government Securities	128.2	138.4	7.9%
Net Loans and Advances	201.3	205.8	2.3%
Total Assets	**385.0**	**417.3**	**8.4%**
Customer Deposits	272.8	301.8	10.6%
Total Liabilities	**318.1**	**346.9**	**9.0%**
Shareholders' Funds	**61.0**	**64.0**	**4.8%**

Balance sheet ratios	Q1'2020	Q1'2021	% point change
Loan to Deposit Ratio	73.8%	68.2%	(5.6%)
Return on average equity	12.6%	5.7%	(6.9%)
Return on average assets	1.9%	0.9%	(1.1%)

Income Statement(mns)	Q1'2020	Q1'2021	y/y change
Net Interest Income	4.7	5.0	6.2%
Net non-Interest Income	1.6	1.6	(1.9%)
Total Operating income	**6.3**	**6.5**	**4.1%**
Loan Loss provision	0.4	0.7	67.7%
Total Operating expenses	3.3	3.5	6.1%
Profit before tax	**3.0**	**3.0**	**1.3%**
Profit after tax	**2.0**	**2.1**	**0.5%**
Core EPS	**7.3**	**7.3**	**0.5%**

Income Statement Ratios	Q1'2020	Q1'2021	% point change
Yield from interest-earning assets	9.8%	9.0%	(0.8%)
Cost of funding	4.5%	4.0%	(0.5%)
Net Interest Spread	5.3%	5.0%	(0.3%)
Net Interest Income as % of operating income	74.6%	76.1%	1.5%
Non-Funded Income as a % of operating income	25.4%	23.9%	(1.5%)
Cost to Income Ratio (CIR)	52.9%	54.0%	1.0%
CIR without provisions	46.4%	43.5%	(3.0%)
Cost to Assets	3.5%	5.0%	1.4%
Net Interest Margin	5.7%	5.3%	(0.4%)

Capital Adequacy Ratios	Q1'2020	Q1'2021
Core Capital/Total Liabilities	23.7%	22.8%
Minimum Statutory ratio	8.0%	8.0%
Excess	15.7%	14.8%
Core Capital/Total Risk Weighted Assets	19.3%	20.8%
Minimum Statutory ratio	10.5%	10.5%
Excess	8.8%	10.3%
Total Capital/Total Risk Weighted Assets	21.0%	22.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	6.5%	7.9%
Liquidity Ratio		

Minimum Statutory ratio	54.7%	58.7%
Excess	20.0%	20.0%
Adjusted Core Capital/Total Liabilities	**34.7%**	**38.7%**
Adjusted Core Capital/Total RWA	**23.4%**	**23.3%**
Adjusted Total Capital/Total RWA	**19.7%**	**21.3%**

Key Highlights Q1'2021

- In Q1'2021, DTB-K committed Kshs 1.6 bn for onward lending to Micro, Small and Medium Enterprises (MSMEs) to aid in recovery amid the pandemic. The bank is expected to advance the bulk of the funding, Kshs 1.2 bn by June 2021. Key to note is that 30.0% of the money is targeted to women, youths and persons living with disability which will help businesses get back to their feet by boosting their working capital, aiding in acquisition of business assets and offsetting enterprises from the impacts of COVID-19.

Income Statement

- The bank's core earnings per share increased marginally by 0.5% to Kshs 7.34, from Kshs 7.30 in Q1'2020, not in line with our expectations. The growth was driven by the 6.1% increase in total operating expenses, which outpaced the 4.1% increase in total operating income to Kshs 6.5 bn from Kshs 6.3 bn in Q1'2020. The variance in the core earnings per share increase against our expectation was mainly attributable to the slower 1.9% decline in Non-Funded Income (NFI) to Kshs 1.56 bn, from Kshs 1.59 bn recorded in Q1'2020, against our expectations of a 17.7% decline to Kshs 1.3 bn in Q1'2021,
- Total operating income increased by 4.1% to Kshs 6.5 bn, from Kshs 6.3 bn in Q1'2020 mainly driven by a 6.2% increase in the Net Interest Income (NII) to Kshs 5.0 bn, from Kshs 4.7 bn in Q1'2020. This was however weighed down by a 1.9% decline in Non-Funded Income (NFI) to Kshs 1.56 bn, from Kshs 1.59 bn in Q1'2020,
- Interest income increased by 4.8% to Kshs 8.3 bn, from Kshs 8.0 bn in Q1'2020 driven by a 58.5% increase in Interest income from deposit placements to Kshs 41.9 mn, from Kshs 26.4 mn in Q1'2020 coupled with a 13.5% increase in interest income from government securities to Kshs 3.5 bn from Kshs 3.1 bn in Q1'2020. On the other hand, interest income from loans and advances declined by 1.1% to Kshs 4.76 bn, from Kshs 4.82 bn in Q1'2020. The Yield on Interest-Earning Assets declined to 9.0% from 9.8% in Q1'2020, attributable to the 4.9% increase in average interest-earning assets to Kshs 347.9 bn, from Kshs 331.7 bn in Q1'2020, which outpaced the 3.6% decline in trailing interest income,
- Interest expense rose by 2.9% to Kshs 3.4 bn, from Kshs 3.3 bn in Q1'2020, following a 5.5% increase in interest expense on customer deposits to Kshs 2.9 bn, from Kshs 2.8 bn in Q1'2020. The increase was however mitigated by a 24.9% decline in interest expense on placement liabilities to Kshs 143.7 mn, from Kshs 191.4 mn in Q1'2020, coupled with a 4.0% decline in other interest expenses to Kshs 286.5 mn, from Kshs 298.3 mn in Q1'2020. Cost of funds, declined by 0.5% points to 4.0% from 4.5% in Q1'2020, owing to the 5.1% decline in trailing interest expenses coupled with a faster 8.7% growth in interest-bearing liabilities, an indication that the bank was able to mobilize cheaper deposits. Net Interest Margin (NIM) declined to 5.3%, from 5.7% in Q1'2020 due to the faster 4.9% growth in average interest-earning assets which outpaced the 3.6% decrease in trailing interest income,
- Non-Funded Income (NFI) declined by 1.9% to Kshs 1.56 bn, from Kshs 1.59 bn in Q1'2020. The decline was mainly driven by the 17.5% decline in fees and commissions on loans to Kshs 313.6 mn, from Kshs 380.2 mn recorded in Q1'2020 coupled with a 22.8% decline in other fees to Kshs 391.8 mn, from Kshs 507.7 mn in Q1'2020. The decline in NFI was however mitigated by a 25.5% increase in foreign exchange trading income to Kshs 701.5 mn, from Kshs 558.7 mn in Q1'2020. Notably, total fees and commissions declined by 20.5% to Kshs 705.4 mn, from Kshs 887.8 mn. As a result, the revenue mix shifted to 76:24 from 75:25 funded to non-funded income, owing to the 6.2% growth in NII as compared to the 1.9% decline in NFI,

- Total operating expenses rose by 6.1% to Kshs 3.5 bn, from Kshs 3.1 bn in Q1’2020, largely driven by the 67.7% increase in Loan Loss Provisions (LLP) to Kshs 0.7 bn, from Kshs 0.4 bn in Q1’2020 on the back of the subdued operating environment seen during the year. Staff costs increased by 2.0% to Kshs 1.22 bn from Kshs 1.20 bn in Q1’2020,
- Cost to Income Ratio (CIR) deteriorated to 54.0%, from 52.9% in Q1’2020 owing to the 6.1% increase in operating expenses to Kshs 3.5 bn, from Kshs 3.1 bn in Q1’2020 which outpaced the 4.1% increase in operating income to Kshs 6.5 bn, from Kshs 6.3 bn in Q1’2020. On the other hand, cost to income ratio without LLP, improved to 43.5%, from 46.4% in Q1’2020, highlighting improved efficiency levels, and,
- Profit before tax increased by 1.3% to Kshs 2.99 bn, from Kshs 2.95 bn in Q1’2020. Profit after tax increased marginally by 0.5% to Kshs 2.1 bn in Q1’2021, from Kshs 2.0 bn recorded in Q1’2020, with the effective tax rate increasing to 31.4%, from 30.9% in Q1’2020.

Balance Sheet

- The balance sheet recorded an expansion as Total Assets increased by 8.4% to Kshs 417.3 bn, from Kshs 385.0 bn recorded in Q1’2020. This growth was largely driven by 12.6% increase in government securities to Kshs 138.4 bn, from Kshs 128.2 bn in Q1’2020, coupled with a 2.3% growth in net loans to Kshs 205.8 bn, from Kshs 201.3 bn in Q1’2020,
- Total liabilities grew by 9.0% to Kshs 346.9 bn, from Kshs 318.1 bn in Q1’2020, driven by a 44.6% increase in borrowings to Kshs 21.8 bn, from Kshs 15.1 bn in Q1’2020, following the additional debts the bank acquired to finance its operations and boost liquidity during the period, coupled with a 10.6% increase in customer deposits to Kshs 301.8 bn from Kshs 272.8 bn in Q1’2020. Deposits per branch increased by 10.6% to Kshs 2.3 bn from Kshs 2.0 bn, as the number of branches remained unchanged at 134 in Q1’2021. However, the number of branches is set to decline as the bank plans to shut down six branches from July 2021 owing to its rising operational costs,
- Loans to deposit ratio declined to 68.2%, from 73.8% in Q1’2020, owing to the faster 10.6% growth in deposits, compared to the 2.3% growth in the net loans during the period,
- Gross Non-Performing Loans (NPLs) rose by 38.1% to Kshs 22.9 bn in Q1’2021, from Kshs 16.6 bn recorded in Q1’2020. Consequently, the NPL ratio rose to 10.6% from 8.0% recorded in Q1’2020, due to the faster 38.1% growth in gross NPLs which outpaced the 3.9% growth in gross loans,
- General Loan Loss Provisions increased by 124.4% to Kshs 10.1 bn from Kshs 4.5 bn in Q1’2020. Consequently, the NPL coverage (having added interest in suspense) increased to 46.5% in Q1’2021, from 42.4% in Q1’2020, owing to the faster 124.4% increase in general provisions, which outpaced the 38.1% growth in Gross NPLs,
- Shareholders’ funds increased by 4.8% to Kshs 64.0 bn in Q1’2021, from Kshs 61.0 bn largely due to the 8.7% increase in the retained earnings to Kshs 53.4 bn, from Kshs 49.1 bn in Q1’2020,
- Diamond Trust Bank is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 20.8%, 10.3% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 22.4%, exceeding the 14.5% statutory requirement by 7.9% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 21.3%, while total capital to risk-weighted assets came in at 22.9%, and,
- The bank currently has a Return on Average Assets (ROaA) of 0.9%, and a Return on Average Equity (ROaE) of 5.7%.

Key Take-Outs:

1. **Asset Quality** - The bank’s asset quality deteriorated, with the NPL ratio increasing to 10.6% in Q1’2021, from 8.0% in Q1’2020, due to the faster 38.1% growth in gross NPLs, which outpaced the 3.9% growth in gross loans. The NPL ratio has been deteriorating q/q and notably, this is the highest it has been for more than a decade attributable to the faster growth in gross NPLs as opposed to the growth in gross loans. Net loans increased by 2.3% to Kshs 205.8 bn, from Kshs 201.3 bn in Q1’2020.

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,

2. There was an improvement in efficiency levels as the cost to income ratio without LLP improved to 46.5% from 43.4% in Q1'2020, an indication of improving efficiency, and,

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

I. **Digital platform** - The bank intends to capitalize on its digital platform to support its business model which will enhance convenience for customers and increase income from digital products as well as service offering, and
II. **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.

Valuation Summary

- We are of the view that Diamond Trust Bank Kenya is a **"BUY"** with a target price of Kshs 75.9, representing an upside of 26.5%, from the current price of Kshs 60.0 as of 28th May 2021,
- Diamond Trust Bank Kenya is currently trading at a P/TBV of 0.3x and a P/E of 4.7x vs an industry average of 0.6x and 7.1x, respectively.