Diamond Trust Bank Kenya – H1'2020
28th August, 2020

Valuation Summary

- We are of the view that Diamond Trust Bank Kenya is a "***buy***" with a target price of Kshs 141.2, representing an upside of 114.8%, from the current price of Kshs 65.8 as of 28th August 2020,
- Diamond Trust Bank Kenya is currently trading at a P/TBV of 0.3x and a P/E of 2.5x vs an industry average of 0.9x and 5.5x, respectively.

Key Highlights H1'2020

- In the wake of the Coronavirus, DTBK has rolled out various interventions including restructuring loans amounting to Kshs 64.0 bn (42.0% of the bank's loan book), expansion of credit lines, loan holidays to enable businesses remain operational during the current period of uncertainty

Income Statement

- The bank's core earnings per share declined by 36.5% to Kshs 9.4, from Kshs 14.8 in H1'2019, lower than our expectation of a 17.8% decline to Kshs 12.1 per share. The variance was mainly attributable to the increase in total operating expenses which rose by 28.1%, higher than our expectations of a 6.8% decline. The bank's performance was driven the increase in total operating expenses, which outweighed the 2.3% increase in total operating income,
- Total operating income rose by 2.3% to Kshs 12.5 bn from Kshs 12.2 bn in H1'2019. This was mainly driven by a 5.9% increase in Non-Funded Income (NFI) to Kshs 3.2 bn, from Kshs 3.0 bn in H1'2019, coupled with a 1.2% increase in Net Interest Income (NII) to Kshs 9.3 bn, from Kshs 9.2 bn in H1'2019,
- Interest income declined by 3.3% to Kshs 15.8 bn from Kshs 16.3 bn in H1'2019. This was driven by a 3.3% decline in interest income from loans and advances to Kshs 9.6 bn from Kshs 9.9 bn in H1'2019, coupled with the 63.9% decline in interest income from deposit placements to Kshs 0.2 bn, from Kshs 0.1 bn in H1'2019. The yield on interest-earning assets declined to 9.7% from 10.3% in H1'2019, attributable to the faster 6.6% increase in average interest earning assets to Kshs 344.1 bn, from Kshs 322.8 bn in H1'2019, that outpaced the 5.3% decline in trailing interest income, largely attributable to the decline in lending rates, which saw interest income decline by 3.3%,
- Interest expenses declined by 9.0% to Kshs 6.5 bn from Kshs 7.2 bn in H1'2019, following a 9.5% decline in interest expense on placement liabilities to Kshs 357.0 mn from Kshs 394.6 mn in H1'2019, coupled with an 8.4.% decline in interest expense on customer deposits to Kshs 5.6 bn, from Kshs 6.1 bn in H1'2019. Cost of funds, declined to 4.4% from 4.8% in H1'2019, owing to the 9.0% decline in interest expenses, despite the 2.7% increase in interest-bearing liabilities. Net Interest Margin (NIM) declined marginally to 5.6%, from 5.8% in H1'2019 due to the 3.3% decline in interest income as compared to the 0.8% increase in average interest-earning assets,
- Non-Funded Income (NFI) rose by 5.9% to Kshs 3.2 bn, from Kshs 3.0 bn in H1'2019. The increase was mainly driven by the 28.7% increase in forex trading income to Kshs 1.3 bn from Kshs 1.0 in H1'2019 coupled with 24.2% growth in the fees and commissions on loans to Kshs 0.7 bn from Kshs 0.6 bn in H1'2019. The growth in NFI was however weighed down by a 19.0% decline in other fees, to Kshs 0.9 bn from Kshs 1.1 bn in H1'2019. As a result, the revenue mix shifted to 75:25 from 76:24 funded to non-funded income, owing to the growth in NFI as compared to the decline in NII,
- Total operating expenses rose by 28.1% to Kshs 8.0 bn, from Kshs 6.2 bn in H1'2019, largely driven by the 249.2% increase in Loan Loss Provisions (LLP) to Kshs 1.9 bn from Kshs 0.5 bn in H1'2019, other

expenses which rose by 7.6%, to Kshs 3.7 bn from Kshs 3.5 bn in H1’2019, and staff costs which increased by 6.8% to Kshs 2.4 bn, from Kshs 2.2 bn,

- The Cost to Income Ratio (CIR) deteriorated to 64.1 %, from 51.2% in H1’2019. Without LLP, the cost to income ratio deteriorated as well to 49.1%, from 46.8% in H1’2019, highlighting a decline in the levels of efficiency,
- Profit before tax fell by 24.7% to Kshs 4.5 bn, from Kshs 6.0 bn in H1’2019. Profit after tax declined by 36.5% to Kshs 2.6 bn in H1’2020, from Kshs 4.1 bn in H1’2019, with the effective tax rate increasing to 31.8% from 28.7% in H1’2019.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 3.3% to Kshs 388.3 bn from Kshs 375.9 bn in H1’2019. This growth was largely driven by a 9.8% increase in government securities to Kshs 132.5 bn from Kshs 120.7 bn in H1’2019, coupled with a 5.6% increase in net loans to Kshs 201.5 bn from Kshs 190.8 bn in H1’2019. The growth in assets was however slowed down by a 26.7% decline in cash and bank placements to Kshs 24.5 bn from Kshs 33.4 bn in H1’2019,
- Total liabilities also rose by 2.5% to Kshs 321.1 bn from Kshs 313.4 bn in H1’2019, driven by an 80.3% increase in placement liabilities to Kshs 15.7 bn from Kshs 8.7 bn in H1’2019, coupled with the 29.2% increase in borrowings to Kshs 17.1 bn from Kshs 13.2 bn in H1’2019. The growth was however mitigated by the 0.1% decline in deposits to Kshs 280.4 bn from Kshs 283.1 bn in H1’2019. Deposits per branch declined by 4.5% to Kshs 2.1 bn from Kshs 2.2 bn in H1’2019, as the number of branches remained unchanged at 137 in H1’2020,
- Loans to deposit ratio increased to 75.2%, from 70.1% in H1’2019, owing to the growth in net loans, coupled with declining customer deposits during the period,
- Gross Non-Performing Loans (NPLs) rose by 16.0% to Kshs 17.5 bn in H1’2020 from Kshs 15.1 bn in H1’2019. Consequently, the NPL ratio deteriorated to 8.3% in H1’2020, from 7.6% in H1’2019, due to the faster 16.0% growth in gross NPLs, which outpaced the 6.2% growth in gross loans. General Loan Loss Provisions increased by 15.5% to Kshs 6.2 bn from Kshs 5.4 bn in H1’2019. Consequently, the NPL coverage increased to 51.2% in H1’2020 from 50.3% in H1’2019, owing to the faster 24.3% growth in interest suspense to Kshs 2.8 bn from Kshs 2.3 bn in H1’2019, that outpaced the 16.0% growth in Gross NPLs,
- Shareholders’ funds increased by 7.2% to Kshs 61.0 bn in H1’2020 from Kshs 56.9 bn in H1’2020, largely due to the 7.6% increase in the retained earnings to Kshs 49.4 bn, from Kshs 45.9 bn in H1’2019,
- Diamond Trust Bank is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 19.3%, 8.8% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 21.0%, exceeding the 14.5% statutory requirement by 6.5% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 19.7%, while total capital to risk-weighted assets came in at 21.4%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.5%, and a Return on Average Equity (ROaE) of 9.8%.

Key Take-Outs:

1. The bank’s asset quality deteriorated, with the NPL ratio increasing to 8.3% in H1’2020, from 7.6% in H1’2019, due to the faster 16.0% growth in gross NPLs, which outpaced the 6.2% growth in gross loans. General Loan Loss Provisions increased by 15.5% to Kshs 6.2 bn from Kshs 5.4 bn in H1’2019, and,

2. The bank recorded an improved performance on the NFI income segment, which rose by 5.9% to Kshs 3.2 bn, from Kshs 3.0 bn in H1’2019. The increase was mainly driven by the 28.7% increase in forex trading income to Kshs 1.3 bn from Kshs 1.0 in H1’2019 coupled with 24.2% growth in the fees and commissions on loans to Kshs 0.7 bn from Kshs 0.6 bn in H1’2019. Consequently the revenue mix shifted to 75:25 from 76:24 funded to non-funded income,

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 their business model which will enhance convenience for customers, having considered the current status quo since the advent of the coronavirus.

Below is a summary of the bank’s performance:

Balance Sheet Items	H1'2019	H1'2020	y/y change	H1'2020	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	120.7	132.5	9.8%	129.2	7.0%	2.8%
Net Loans and Advances	190.8	201.5	5.6%	188.3	(1.3%)	6.9%
Total Assets	**375.9**	**388.3**	**3.3%**	**382.7**	**1.8%**	**1.5%**
Customer Deposits	283.1	280.4	(1.0%)	273.1	(3.5%)	2.6%
Total Liabilities	313.4	321.1	2.5%	316.9	1.1%	1.4%
Shareholders’ Funds	**56.9**	**61.0**	**7.2%**	**59.9**	**5.3%**	**1.9%**

Balance Sheet Ratios	H1'2019	H1'2020	y/y change
Loan to Deposit Ratio	67.4%	71.9%	4.5%
Return on average equity	13.2%	9.8%	(3.5%)
Return on average assets	1.9%	1.5%	(0.4%)

Income Statement	H1'2019	H1'2020	y/y change	H1'2020	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	9.2	9.3	1.2%	7.8	(14.6%)	15.8%
Net non-Interest Income	3.0	3.2	5.9%	2.7	(7.8%)	13.6%
Total Operating income	**12.2**	**12.4**	**2.3%**	**10.6**	**(12.9%)**	**15.3%**
Loan Loss provision	0.5	1.9	249.2%	0.8	56.2%	193.1%
Total Operating expenses	6.2	8.0	28.1%	5.7	(7.7%)	35.8%
Profit before tax	**6.0**	**4.5**	**(24.7%)**	**4.9**	**(18.5%)**	**(6.2%)**
Profit after tax	**4.1**	**2.6**	**(36.5%)**	**3.4**	**(17.8%)**	**(18.7%)**

Income Statement Ratios	H1'2019	H1'2020	y/y change
Yield from interest-earning assets	10.3%	9.7%	(0.6%)
Cost of funding	4.8%	4.4%	(0.4%)
Net Interest Spread	5.5%	5.3%	(0.2%)
Net Interest Income as % of operating income	75.5%	74.7%	(0.9%)
Non-Funded Income as a % of operating income	24.5%	25.3%	0.9%

Cost to Income Ratio (CIR)	51.2%	64.1%	12.9%
CIR without provisions	46.8%	49.1%	2.3%
Cost to Assets	3.6%	3.9%	0.3%
Net Interest Margin	5.8%	5.6%	(0.2%)

Capital Adequacy Ratios	H1'2019	H1'2020
Core Capital/Total Liabilities	20.3%	23.4%
Minimum Statutory ratio	8.0%	8.0%
Excess	**12.3%**	**15.4%**
Core Capital/Total Risk Weighted Assets	18.9%	19.3%
Minimum Statutory ratio	10.5%	10.5%
Excess	**8.4%**	**8.8%**
Total Capital/Total Risk Weighted Assets	21.1%	21.0%
Minimum Statutory ratio	14.5%	14.5%
Excess	**6.6%**	**6.5%**
Liquidity Ratio	54.3%	54.4%
Minimum Statutory ratio	20.0%	20.0%
Excess	**34.3%**	**34.4%**