Cytonn INVESTMENTS

Diamond Trust Bank Kenya – Q1'2020

22ndMay, 2020

Valuation Summary

- We are of the view that Diamond Trust Bank Kenya is a "***buy***" with a target price of Kshs 182.5, representing an upside of 146.7%, from the current price of Kshs 74.0 as of 22nd May 2020, inclusive of a dividend yield of 3.6%,
- Diamond Trust Bank Kenya is currently trading at a P/TBV of 0.4x and a P/E of 2.8x vs an industry average of 1.0 x and 5.4x, respectively.

Key Highlights Q1'2020

- Diamond Trust Bank (DTB) committed KSh.100 mn towards cushioning Kenyans against the effects of the COVID-19 pandemic. DTBK will channel Kshs 50.0 mn directly to the COVID-19 Emergency Response Fund towards interventions for providing relief for the vulnerable families of the Kenyan Society. The other Kshs 50.0 mn will be used towards various initiatives that the Bank would want to be involved in.DTBK is also supporting the provision of meals to frontline workers at Kenyatta National Hospital and Mbagathi Hospital Isolation Facility in collaboration with the Nairobi Serena Hotel. The Bank is also financing the setting up of 40 beds at the recently commissioned Field Hospital by the Aga Khan University Hospital Nairobi.

Income Statement

- Diamond Trust Bank Kenya released their Q1'2020 financial results, with core earnings per share increasing by 3.7% to Kshs 7.3, from Kshs 7.0 in Q1'2019, in line with our expectations. The performance was driven by the 3.0% increase in total operating income to Kshs 6.3 bn from Kshs 6.1 bn in Q1'2019 despite the 5.2% rise in total expenses,
- Total operating income increased by 3.0% to Kshs 6.3 bn from Kshs 6.1 bn in Q1'2019. This was due to a 3.4% increase in Non-Funded Income (NFI) to Kshs 1.6 bn, from Kshs 1.5 bn in Q1'2019, coupled with a, 2.9% increase in Net Interest Income (NII) to Kshs 4.7 bn, from Kshs 4.5 bn in Q1'2019,
- Interest income declined by 2.4% to Kshs 8.0 bn from Kshs 8.2 bn in Q1'2019. This was driven by a 1.8% decline in interest income from loans and advances to Kshs 4.8 bn, from Kshs 4.9 bn in Q1'2019, coupled up with a 1.2% decline in interest income from government securities to Kshs 3.11 bn from Kshs 3.14 bn in Q1'2019. The interest income from deposit placements declined by 72.0% to Kshs 26.4 mn from Kshs 94.4 mn in Q1'2019. The yield on interest-earning assets declined to 9.8% from 10.7% in Q1'2019, attributable to the 2.4% decline in interest income, despite the 1.7% growth in average interest-earning assets to Kshs 331.7 bn from Kshs 326.3 in Q1'2019,
- Interest expense declined by 9.0% to Kshs 3.3 bn from Kshs 3.6 bn in Q1'2019, following a 15.2% decline in interest expense on placement to Kshs 0.19 bn from Kshs 0.23 bn in Q1'2019, as well as a7.8% decline in interest expense on customer deposits to Kshs 2.8 bn from Kshs 3.0 bn in Q1'2019. Cost of funds declined to 4.5% from 5.0% in Q1'2019, owing to 9.0% decline in interest expenses, despite the 0.3% increase in average interest-bearing liabilities to Kshs 305.9 bn from Kshs 304.9 bn in Q1'2019. Net Interest Margin (NIM) declined to 5.7%, from 6.0% in Q1'2019 due to a 4.3% decline in trailing NII, despite the 1.7% growth in average Interest-Earning Assets,
- Non-Funded Income (NFI) rose by 3.4% to Kshs 1.6 bn, from Kshs 1.5 bn in Q1'2019. The increase was mainly driven by a 39.3% increase in fees and commissions to Kshs 0.4 bn from Kshs 0.3 in Q1'2019. The growth in NFI was however weighed down by the 13.1% decline in forex trading income, to Kshs 55.9 mn from Kshs 64.3 mn in Q1'2019. The revenue mix remained unchanged at 75:25 funded and non-funded,
- Total operating expenses increased by 5.2% to Kshs 3.3 bn from Kshs 3.2 bn in Q1'2019, largely driven by the 52.0% increase in Loan Loss Provisions (LLP) to Kshs 0.4 bn from Kshs 0.3 bn in Q1'2019, staff costs,

which rose by 10.4% to Kshs 1.20 bn from Kshs 1.08 bn in Q1'2019. Other operating expenses however declined by 4.9% to Kshs 1.7 bn from Kshs 1.8 bn in Q1'2019,
- The Cost to Income Ratio (CIR) deteriorated to 52.9 %, from 51.8% in Q1'2019. However, without LLP, the cost to income ratio improved to 46.4%, from 47.4% in Q1'2019, highlighting improved efficiency levels,
- Profit before tax rose by 0.5% to Kshs 3.0 bn, from Kshs 2.9 bn in Q1'2019. Profit after tax grew by 3.7% to Kshs 2.04 bn in Q1'2020, from Kshs 1.97 bn in Q1'2019, with the effective tax rate declining to 30.9% from 33.0% in Q1'2019,

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 4.0% to Kshs 385.0 bn from Kshs 370.1 bn in Q1'2019. This growth was largely driven by a 6.7% increase in net loans to Kshs 201.3 bn from Kshs 188.6 bn in Q1'2019, coupled with a 1.9% increase in government securities to Kshs 128.2 bn from Kshs 125.8 bn in Q1'2019. The growth in assets was however slowed down by a 21.9% decline in placements to Kshs 8.6 bn from Kshs 11.1 bn in Q1'2019,
- Total liabilities rose by 2.8% to Kshs 318.1 bn from Kshs 309.3 bn in Q1'2019, driven by an 82.6% increase in placement liabilities to Kshs 23.4 bn from Kshs 12.8 bn in Q1'2019, coupled with the 20.3% increase in borrowings to Kshs 15.1 bn from Kshs 12.5 bn in Q1'2019. The growth was however slowed by the 20.7% decline in other liabilities to Kshs 6.9 bn from Kshs 8.7 bn in Q1'2019, coupled with a 0.9% decline in customer deposits to Kshs 272.8 bn from Kshs 275.3 bn in Q1'2019. Deposits per branch declined by 0.9% to Kshs 1.99 bn from Kshs 2.01 bn in Q1'2019, as the number of branches remaining unchanged at 137 in Q1'2020,
- Loans to deposit ratio increased to 73.8% from 68.5% in Q1'2019, owing to the 6.7% growth in net loans, with customer deposits having declined by 0.9% during the same period,
- Gross Non-Performing Loans (NPLs) rose by 15.7% to Kshs 16.6 bn in Q1'2020 from Kshs 14.4 bn in Q1'2019. Consequently, the NPL ratio deteriorated to 8.0% in Q1'2020 from 7.3% in Q1'2019 owing to slower growth in gross loans by 6.4% outpacing the 15.7% growth in gross non-performing loans. General Loan Loss Provisions declined by 14.5% to Kshs 4.5 bn from Kshs 5.3 bn in Q1'2019. Consequently, the NPL coverage declined to 42.4% in Q1'2020 from 50.7% in Q1'2019 due to the decline in General Loan Loss Provisions which was outpaced the growth in Gross Non-Performing Loans (NPLs),
- Shareholders' funds increased by 10.1% to Kshs 61.0 bn in Q1'2020 from Kshs 55.5 bn in Q1'2019, largely due to the 11.9 % increase in the retained earnings to Kshs 49.1 bn, from Kshs 43.9 bn in Q1'2019,
- 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 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 21.5%,
- The bank currently has a Return on Average Assets (ROaA) of 1.9%, and a Return on Average Equity (ROaE) of 12.6%.

Key Take-Outs:

1. The bank's asset quality deteriorated, with the NPL ratio increasing to 8.0% from 7.3% in Q1'2019 owing to slower growth in gross loans by 6.4% outpacing the 15.7% growth in gross non-performing loans. The decline in asset quality is attributable to a 15.7% increase in the gross NPLs to Kshs 16.6 bn in Q1'2020 from Kshs 14.4 bn in Q1'2019,

2. The bank recorded improved performance in NFI income, which recorded a 3.4% growth y/y, largely supported by the 67.2% growth in other non-interest income, coupled with a 39.3% increase in fees and commissions. Consequently, NFI contribution to total income rose by 0.1% to 25.4% from 25.3% in Q1’2019. This, however, remains below the current industry average of 21.6%,
3. There was an improvement in efficiency levels as the cost to income ratio without LLP improved to 46.4%, from 47.4% in Q1’2019. The improvement was largely attributable to a 4.9% decline in other expenses.

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

1. **Geographical diversification*:*** The bank’s forays into other markets such as Tanzania, Uganda, and Burundi, may aid the bank’s growth, given the lack of loan pricing controls in those markets. Continued focus on those markets would aid in alleviating the compressed interest income regime in the Kenyan market.

Below is a summary of the bank’s performance:

Balance Sheet Items	Q1'2019	Q1'2020	y/y change	Q1'2020e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	125.8	128.2	1.9%	131.8	4.8%	(2.9%)
Net Loans and Advances	188.6	201.3	6.7%	193.5	2.6%	4.1%
Total Assets	370.1	385.0	4.0%	379.3	2.5%	1.5%
Customer Deposits	275.3	272.8	(0.9%)	280.5	1.9%	(2.8%)
Total Liabilities	309.3	318.1	2.8%	312.9	1.1%	1.7%
Shareholders’ Funds	55.4	61.0	10.1%	60.8	9.6%	0.5%

Balance Sheet Ratios	Q1'2019	Q1'2020	y/y change
Loan to Deposit Ratio	68.5%	73.8%	5.3%
Return on average equity	13.8%	12.6%	(1.2%)
Return on average assets	2.0%	1.9%	(0.0%)

Income Statement	Q1'2019	Q1'2020	y/y change	Q1'2020e	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	4.5	4.7	2.9%	4.9	8.6%	(5.7%)
Net non-Interest Income	1.5	1.6	3.4%	1.5	0.4%	2.9%
Total Operating income	6.08	6.26	3.0%	6.48	6.5%	(3.5%)
Loan Loss provision	0.3	0.4	52.0%	(0.8)	(410.6%)	462.7%
Total Operating expenses	3.2	3.3	5.2%	(3.6)	(212.9%)	218.2%
Profit before tax	2.9	3.0	0.5%	2.9	(0.4%)	0.9%
Profit after tax	2.0	2.0	3.7%	2.0	4.1%	(0.4%)

Income Statement Ratios	Q1'2019	Q1'2020	y/y change
Yield from interest-earning assets	10.7%	9.8%	(0.8%)
Cost of funding	5.0%	4.5%	(0.4%)
Net Interest Spread	5.7%	5.3%	(0.4%)
Net Interest Income as % of operating income	74.7%	74.6%	(0.1%)
Non-Funded Income as a % of operating income	25.3%	25.4%	0.1%

Cost to Income Ratio (CIR)	51.8%	52.9%	1.1%
CIR without provisions	47.4%	46.4%	(1.0%)
Cost to Assets	3.8%	3.5%	(0.3%)
Net Interest Margin	6.0%	5.7%	(0.4%)

Capital Adequacy Ratios	Q1'2019	Q1'2020
Core Capital/Total Liabilities	20.3%	23.7%
Minimum Statutory ratio	8.0%	8.0%
Excess	**12.3%**	**15.7%**
Core Capital/Total Risk Weighted Assets	18.5%	19.3%
Minimum Statutory ratio	10.5%	10.5%
Excess	**8.0%**	**8.8%**
Total Capital/Total Risk Weighted Assets	20.7%	21.0%
Minimum Statutory ratio	14.5%	14.5%
Excess	**6.2%**	**6.5%**
Liquidity Ratio	53.4%	54.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	**33.4%**	**34.7%**