Diamond Trust Bank Kenya – Q3’2020

27th November, 2020

Valuation Summary

- We are of the view that Diamond Trust Bank Kenya is a “***buy***” with a target price of Kshs 127.8, representing an upside of 101.3%, from the current price of Kshs 63.5 as of 26th November 2020,
- Diamond Trust Bank Kenya is currently trading at a P/TBV of 0.3x and a P/E of 3.9x vs an industry average of 0.9x and 5.5x, respectively.

Key Highlights Q3’2020

- In addition to the various interventions that DTBK rolled out to help businesses remain afloat during the COVID-19 pandemic, the bank signed a USD 50 mn loan with International Finance Corporation (IFC) to brace its small and medium entreprise borrowers who have been hit hard by the turn out of the virus,

Income Statement

- The bank’s core earnings per share declined by 27.8% to Kshs 15.5, from Kshs 21.4 in Q3’2019, lower than our expectation of a 41.2% decline to Kshs 12.6 per share. The variance was mainly attributable to the increase in total operating income which rose by 4.4%, higher than our expectations of an 8.9% decline. The bank’s performance was driven by the 30.4% rise in total operating expenses, which outweighed the 4.4% increase in total operating income,
- Total operating income rose by 4.4% to Kshs 18.9 bn from Kshs 18.2 bn in Q3’2019. This was mainly driven by a 15.3% increase in Non-Funded Income (NFI) to Kshs 5.0 bn, from Kshs 4.4 bn in Q3’2019, coupled with a 0.9% increase in Net Interest Income (NII) to Kshs 13.9 bn, from Kshs 13.8 bn in Q3’2019,
- Interest income declined by 3.4% to Kshs 23.7 bn from Kshs 24.5 bn in Q3’2019. This was driven by a 3.3% decline in interest income from loans and advances to Kshs 14.3 bn from Kshs 14.8 bn in Q3’2019, coupled with the 1.1% decline in interest income from deposit placements to Kshs 9.2 bn, from Kshs 9.3 bn in Q3’2019. The yield on interest-earning assets declined as well to 9.3% from 9.9% in Q3’2019, attributable to the faster 5.3% increase in average interest-earning assets to Kshs 351.4 bn, from Kshs 333.8 bn in Q3’2019, despite the 3.9% decline in trailing interest income,
- Interest expense declined by 8.9% to Kshs 9.8 bn from Kshs 10.7 bn in Q3’2019, following an 11.8% decline in interest expense on placement liabilities to Kshs 487.2mn from Kshs 552.6 mn in Q3’2019, coupled with an 8.3% decline in interest expense on customer deposits to Kshs 8.4 bn, from Kshs 9.2 bn in Q3’2019. Cost of funds, declined to 4.2% from 4.6% in Q3’2019, owing to the 8.9% decline in interest expenses, against a slower 1.8% growth in interest-bearing liabilities, an indication that the bank managed to mobilize cheaper deposits. Net Interest Margin (NIM) declined marginally to 5.5%, from 5.6% in Q3’2019 due to the 3.4% decline in interest income, despite the 5.3% increase in average interest-earning assets,
- Non-Funded Income (NFI) rose by 15.3% to Kshs 5.0 bn, from Kshs 4.4 bn in Q3’2019. The increase was mainly driven by the 37.2% increase in forex trading income to Kshs 1.9 bn from Kshs 1.4 in Q3’2019 coupled with 17.7% growth in the fees and commissions on loans to Kshs 1.1 bn from Kshs 1.0 bn in Q3’2019. The growth in NFI was however weighed down by a 16.8% decline in other fees, to Kshs 1.3 bn from Kshs 1.6 bn in Q3’2019. As a result, the revenue mix shifted to 73:27 from 76:24 funded to non-funded income, owing to the faster 15.3% growth in NFI which outpaced the 0.9% growth in NII,
- Total operating expenses rose by 30.4% to Kshs 12.4 bn, from Kshs 9.5 bn in Q3’2019, largely driven by the 232.1% increase in Loan Loss Provisions (LLP) to Kshs 2.9 bn from Kshs 0.9 bn in Q3’2019. Other expenses rose by 12.6%, to Kshs 5.9 bn from Kshs 5.2 bn in Q3’2019, and staff costs which increased by 5.9% to Kshs 3.6 bn, from Kshs 3.4 bn,

- Cost to Income Ratio (CIR) deteriorated to 65.2 %, from 52.2% in Q3'2019. Without LLP, the cost to income ratio deteriorated as well to 50.0%, from 47.4% in Q3'2019, highlighting a decline in the levels of efficiency,
- Profit before tax fell by 24.0% to Kshs 6.6 bn, from Kshs 8.7 bn in Q3'2019. Profit after tax declined by 27.8% to Kshs 4.3 bn in Q3'2020, from Kshs 6.0 bn in Q3'2019, with the effective tax rate increasing to 34.5% from 31.0% in Q3'2019.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 3.0% to Kshs 394.0 bn from Kshs 382.5 bn in Q3'2019. This growth was largely driven by a 7.1% increase in net loans to Kshs 205.6 bn from Kshs 192.0 bn in Q3'2019, coupled with a 5.1% increase in government securities to Kshs 134.1 bn from Kshs 127.5 bn in Q3'2019. The growth in assets was however slowed down by a 19.9% decline in cash and bank placements to Kshs 22.4 bn from Kshs 28.0 bn in Q3'2019,
- Total liabilities also rose by 2.2% to Kshs 324.9 bn from Kshs 317.8 bn in Q3'2019, driven by a 60.8% increase in borrowings to Kshs 20.2 bn from Kshs 12.6 bn in Q3'2019, coupled with a 1.8% increase in deposits to Kshs 288.2 bn from Kshs 283.1 bn in Q3'2019. Key to note, the bank has three long-term subordinate debts facilities from the International Finance Corporation (IFC) and African Development Bank amounting to USD 46.0 mn (Kshs 5.0 bn). The growth in total liabilities was however weighed down by the 35.6% decline in placements to Kshs 9.2 bn from Kshs 14.3 bn in Q3'2019. Deposits per branch remained unchanged at Kshs 2.1 bn, as the number of branches remained unchanged at 137 in Q3'2020,
- Loans to deposit ratio increased to 71.4%, from 67.8% in Q3'2019, owing to the 7.1% growth in net loans, coupled with the 1.8% decline in customer deposits during the period,
- Gross Non-Performing Loans (NPLs) rose by 3.4% to Kshs 18.5 bn in Q3'2020 from Kshs 17.9 bn in Q3'2019. Consequently, the NPL ratio improved to 8.7% in Q3'2020, from 8.9% in Q3'2019, due to the faster 11.2% growth in gross loans which outpaced the 3.4% growth in gross NPLs,
- General Loan Loss Provisions increased by 13.3% to Kshs 6.5 bn from Kshs 5.7 bn in Q3'2019. Consequently, the NPL coverage (having added interest in suspense) increased to 54.7% in Q3'2020 from 48.0% in Q3'2019, owing to the faster 86.4% growth in interest suspense to Kshs 5.3 bn from Kshs 2.8 bn in Q3'2019, that outpaced the 25.0% growth in Gross NPLs,
- Shareholders' funds increased by 6.6% to Kshs 62.8 bn in Q3'2020 from Kshs 58.9 bn, largely due to the 26.7% increase in the retained earnings to Kshs 51.2 bn, from Kshs 40.4 bn in Q3'2019, which was weighed down by a 90.2% decline in revaluation reserve to Kshs 0.1 bn in Q3' 2020 from Kshs 1.3 bn in Q3'2019,
- Diamond Trust Bank is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 19.2%, 8.7% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 20.8%, exceeding the 14.5% statutory requirement by 6.3% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 19.6%, while total capital to risk-weighted assets came in at 21.2%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.4%, and a Return on Average Equity (ROaE) of 9.2%.

Key Take-Outs:

i. **Asset quality:** The bank’s asset quality deteriorated, with the NPL ratio increasing to 10.5% in Q3’2020, from 8.9% in Q3’2019, due to the faster 25.0% growth in gross NPLs, which outpaced the 11.2% growth in gross loans. Borrowings increased by 60.8% to Kshs 20.2 bn from Kshs 12.6 bn in Q3’2019, and,
ii. The bank recorded an improved performance on the NFI income segment, which rose by 15.3% to Kshs 5.0 bn, from Kshs 4.4 bn in Q3’2019. The increase was mainly driven by the 54.2% increase in other income to Kshs 0.67 bn from Kshs 0.44 in Q3’2019 coupled with 37.2% growth in forex trading income to Kshs 1.9 bn from Kshs 1.4 bn in Q3’2019. Consequently, the revenue mix shifted to 73:25 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 its 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	Q3'2019	Q3'2020	y/y change	Q3'2020f	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	127.5	134.1	5.1%	136.2	6.8%	(1.7%)
Net Loans and Advances	192.0	205.6	7.1%	202.0	5.2%	1.9%
Total Assets	**382.5**	**394.0**	**3.0%**	**395.2**	**3.3%**	**(0.3%)**
Customer Deposits	283.1	288.2	1.8%	288.1	1.8%	0.0%
Total Liabilities	317.8	324.9	2.2%	329.3	3.6%	(1.4%)
Shareholders’ Funds	**58.9**	**62.8**	**6.6%**	**59.7**	**1.4%**	**5.2%**

Balance Sheet Ratios	Q3'2019	Q3'2020	y/y change
Loan to Deposit Ratio	67.8%	71.4%	3.5%
Return on average equity	13.4%	9.2%	(4.2%)
Return on average assets	1.4%	1.4%	0.0%

Income Statement	Q3'2019	Q3'2020	y/y change	Q3'2020f	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	13.8	13.9	0.9%	12.0	(12.9%)	13.9%
Net non-Interest Income	4.4	5.0	15.3%	4.5	4.0%	11.3%
Total Operating income	**18.2**	**18.9**	**4.4%**	**16.5**	**(8.9%)**	**13.2%**
Loan Loss provision	0.9	2.9	232.1%	3.0	242.3%	(10.2%)
Total Operating expenses	9.5	12.4	30.4%	10.6	11.3%	19.1%
Profit before tax	**8.7**	**6.6**	**(24.0%)**	**6.0**	**(31.0%)**	**7.0%**

Profit after tax	**6.0**	**4.3**	**(27.8%)**	**3.5**	**(41.4%)**	**13.6%**

Income Statement Ratios	Q3'2019	Q3'2020	y/y change
Yield from interest-earning assets	9.9%	9.3%	(0.5%)
Cost of funding	4.6%	4.2%	(0.4%)
Net Interest Spread	5.3%	5.1%	(0.2%)
Net Interest Income as % of operating income	75.9%	73.4%	(2.5%)
Non-Funded Income as a % of operating income	24.1%	26.6%	2.5%
Cost to Income Ratio (CIR)	52.2%	65.2%	13.0%
CIR without provisions	47.4%	50.0%	2.6%
Cost to Assets	3.4%	4.1%	0.7%
Net Interest Margin	5.6%	5.5%	(0.1%)

Capital Adequacy Ratios	Q3'2019	Q3'2020
Core Capital/Total Liabilities	21.0%	23.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**13.0%**	**15.3%**
Core Capital/Total Risk-Weighted Assets	19.1%	19.2%
Minimum Statutory ratio	10.5%	10.5%
Excess	**8.6%**	**8.7%**
Total Capital/Total Risk-Weighted Assets	21.2%	20.8%
Minimum Statutory ratio	14.5%	14.5%
Excess	**6.7%**	**6.3%**
Liquidity Ratio	55.6%	53.6%
Minimum Statutory ratio	20.0%	20.0%
Excess	**35.6%**	**33.6%**