Diamond Trust Bank Kenya– Q3’2022

25th November, 2022

Below is a summary of Diamond Trust Bank Kenya’s Q3’2022 performance:

Balance Sheet Items (Kshs bn)	Q3'2021	Q3'2022	y/y change
Government Securities	115.1	135.1	17.4%
Net Loans and Advances	205.6	243.7	18.5%
Total Assets	**434.4**	**507.5**	**16.8%**
Customer Deposits	323.7	359.7	11.1%
Deposits per Branch	2.5	2.7	9.4%
Total Liabilities	**359.9**	**429.5**	**19.3%**
Shareholders’ Funds	**67.5**	**70.1**	**3.9%**

Balance Sheet Ratios	Q3'2021	Q3'2022	y/y change
Loan to Deposit Ratio	63.5%	67.7%	4.2%
Return on average equity	6.8%	8.0%	1.2%
Return on average assets	1.1%	1.2%	0.1%

Income Statement (Kshs bn)	Q3'2021	Q3'2022	y/y change
Net Interest Income	14.7	16.8	14.1%
Non-Interest Income	4.8	6.9	43.5%
Total Operating income	**19.5**	**23.7**	**21.3%**
Loan Loss provision	3.1	4.0	30.5
Total Operating expenses	12.1	14.7	21.5%
Profit before tax	7.4	8.9	20.2%
Profit after tax	**5.2**	**6.3**	**21.1%**
Earnings per share (Kshs)	**18.6**	**22.5**	**21.1%**

Income Statement Ratios	Q3'2021	Q3'2022	Y/Y Change
Yield from interest-earning assets	9.5%	9.7%	0.2%
Cost of funding	3.1%	3.2%	0.1%
Net Interest Spread	6.4%	6.5%	0.1%
Net Interest Income as % of Total Income	75.5%	71.0%	(4.5%)
Non-Funded Income as a % of Total Income	24.5%	29.0%	4.5%
Cost to Income	62.0%	62.1%	0.1%
Cost to Income Ratio without provisions	46.3%	45.2%	(1.1%)
Cost to Assets	4.7%	4.8%	0.1%
Net Interest Margin	5.5%	5.7%	0.2%

Capital Adequacy Ratios	Q3'2021	Q3'2022	% points change
Core Capital/Total deposit Liabilities	22.2%	21.9%	(0.3%)
Minimum Statutory ratio	8.0%	8.0%	
Excess	**14.2%**	**13.9%**	**(0.3%)**
Core Capital/Total Risk Weighted Assets	20.7%	20.0%	(0.7%)
Minimum Statutory ratio	10.5%	10.5%	
Excess	**10.2%**	**9.5%**	**(0.7%)**
Total Capital/Total Risk Weighted Assets	22.1%	21.1%	(1.0%)
Minimum Statutory ratio	14.5%	14.5%	
Excess	**7.6%**	**6.6%**	**(1.0%)**
Liquidity Ratio	60.1%	60.5%	0.4%
Minimum Statutory ratio	20.0%	20.0%	

Excess	**40.1%**	**40.5%**	**0.4%**
Adjusted Core Capital/Total Deposit Liabilities	22.3%	21.8%	(0.5%)
Adjusted Core Capital/Total Risk Weighted Assets	20.9%	20.0%	(0.9%)
Adjusted Total Capital/Total Risk Weighted Assets	22.2%	21.1%	(1.1%)

Income Statement

- Core earnings per share increased by 21.1% to Kshs 22.5 in Q3'2022, from Kshs 18.6 in Q3'2021, higher than our projections of 15.2% increase to Kshs 21.4. The performance was driven by a 21.3% increase in total operating income to Kshs 23.7 bn in Q3'2022, from Kshs 19.5 bn in Q3'2021. However, this increase in total operating income was weighed down by the 21.5% increase in the total operating expenses to Kshs 14.7 bn in Q3'2022, from Kshs 12.1 bn in Q3'2021,
- Total operating income rose by 21.3% to Kshs 23.7 bn in Q3'2022, from Kshs 19.5 bn in Q3'2021 mainly driven by an 14.1% increase in Net Interest Income (NII) to Kshs 16.8 bn, from Kshs 14.7 bn in Q3'2021 coupled with a 43.5% growth in Non-Funded Income (NFI) to Kshs 6.9 bn, from Kshs 4.8 bn in Q3'2021,
- Interest income rose by 15.4% to Kshs 29.0 bn in Q3'2022, from Kshs 25.1 bn in Q3'2021 driven by a 9.4% increase in interest income from loans and advances to Kshs 15.2 bn, from Kshs 13.9 bn in Q3'2021, coupled with a 23.4% increase in interest income from government securities to Kshs 13.6 bn, from Kshs 11.0 bn in Q3'2021. The Yield on Interest-Earning Assets increased by 0.2% points to 9.7%, from 9.5% in Q3'2021 due to the faster 16.2% growth in the trailing interest income, which outpaced the 13.1% growth in average interest-earning assets. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense increased by 17.2% to Kshs 12.2 bn in Q3'2022, from Kshs 10.4 bn in Q3'2021, largely due to a 14.1% growth in interest expense on customer deposits to Kshs 10.5 bn, from Kshs 9.2 bn in Q3'2021 coupled with a 125.4% increase in deposits and placements from banking institutions to Kshs 0.7 bn from Kshs 0.3 bn in Q3'2021. Additionally, Cost of funds (COF) increased by 0.1% points to 3.2%, from 3.1% as recorded in Q3'2021, owing to the 15.3% increase in trailing interest expense, which outpaced the 14.3% increase in average interest bearing liabilities. On the other hand, Net Interest Margin (NIM) increased by 0.2% to 5.7% from 5.5% recorded in Q3'2021, attributable to the faster 16.8% growth in trailing Net interest income average which outpaced the 13.1% growth in Average interest earning assets,
- Non-Funded Income increased by 14.1% to Kshs 16.8 bn in Q3'2022, from Kshs 14.7 bn in Q3'2021, mainly driven by a 80.6% rise in foreign exchange trading income to Kshs 3.3 bn, from Kshs 1.8 bn in Q3'2021, partly attributable to the bank's increased trading margins. Additionally, fees and commissions from loans and advances increased by 35.1% to Kshs 1.3 bn, from Kshs 1.0 bn in Q3'2021, following a 18.5% increase in Net loans and advances to Kshs 243.7 bn, from Kshs 205.6 bn in Q3'2021. DTB-K's total fees and commissions increased by 24.5% to Kshs 3.0 bn in Q3'2022, from Kshs 2.4 bn in Q3'2021. As a result, the revenue mix shifted to 71:29 funded to non-funded income, from 75:25 funded to non-funded income in Q3'2022, owing to the 43.5% increase in NFI which outpaced the 14.1% growth in NII,
- Total operating expenses increased by 21.5% to Kshs 14.7 bn in Q3'2022, from Kshs 12.1 bn in Q3'2021, largely driven by an 20.0% increase in staff costs to Kshs 4.4 bn, from Kshs 3.6 bn in Q3'2021 coupled with a 17.3% increase in other operating expenses to Kshs 6.3 bn, from Kshs 5.4 bn in Q3'2021. Notably, Loan Loss Provisions (LLP) increased by 30.5% to Kshs 4.0 bn from Kshs 3.1 bn in Q3'2021, an indication of perceived increased credit risk in the sectors that the bank lends to,
- The Cost to Income Ratio (CIR) slightly increased to 62.1% in Q3'2022, from 62.0% in Q3'2021 owing to the 21.5% increase in the total operating expenses which outpaced the 21.3% increase in the total operating income. Without LLP, the Cost to Income ratio improved to 45.2%, from 46.3% in Q3'2021, an indication of improving efficiency levels, and,

- Profit before tax and exceptional items rose by 20.2% to Kshs 8.9 bn, from Kshs 7.4 bn in Q3’2021, with the effective tax rate increasing to 38.3% in Q3’2022, from 34.0% seen in Q3’2021. Similarly, the bank recorded a 21.1% increase in profit after tax to Kshs 6.3 bn in Q3’2022, from Kshs 5.2 bn in Q3’2021.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 16.8% to Kshs 507.5 bn in Q3’2022, from Kshs 434.4 bn in Q3’2021, mainly attributable the 18.5% growth in net loans and advances to Kshs 243.7 bn in Q3’2022, from Kshs 205.6 bn in Q3’2021, coupled with the 17.4% increase government securities to Kshs 135.1 bn, from Kshs 115.1 bn recorded in Q3’2021,
- Total liabilities grew by 19.3% to Kshs 429.5 bn, from Kshs 359.9 bn in Q3’2021, largely attributable to a 11.1% rise in customer deposits to Kshs 359.7 bn in Q3’2022, from Kshs 323.7 bn in Q3’2021 and a significant 388.6% growth in placements to Kshs 37.1 bn from Kshs 7.6 bn recorded in Q3’2021. Deposits per branch increased by 9.4% to Kshs 2.7 bn, from Kshs 2.5 bn in Q3’2021, with the number of branches increasing to 132 in Q3’2022 from 130 in Q3’2021,
- The faster 18.5% growth in net loans and advances compared to the 11.1% growth in deposits, led to an increase in the loan to deposit ratio to 67.7%, from 63.5% in Q3’2021,
- Gross Non-Performing Loans (NPLs) increased by 28.1% to Kshs 33.0 bn in Q3’2022, from Kshs 25.7 bn in Q3’2021. Consequently, the NPL ratio increased to 12.7% in Q3’2022, from 11.9% in Q3’2021, owing to the 28.1% growth in gross non-performing loans, which outpaced the 18.5% increase in net loans and advances to Kshs 243.7 bn, from Kshs 205.6 bn in Q3’2021,
- Provisions increased by 30.5% to Kshs 4.0 bn, from Kshs 3.1bn in Q3’2021, with the bank increasing provisioning following the deterioration in asset quality. The NPL coverage ratio consequently improved to 45.2% in Q3’2022, from 40.0% in Q3’2021, due to the faster 30.5% growth in provisions which outpaced the 28.1% increase in Gross Non-Performing Loans (NPLs),
- Shareholders’ funds increased by 3.9% to Kshs 70.1 bn in Q3’2022, from Kshs 67.5 bn in Q3’2021, mainly driven by a 6.4% increase in the retained earnings to Kshs 59.7 bn, from Kshs 56.1 bn in Q3’2021,
- DTB-K Ltd remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 20.0%, 9.5% points above the statutory requirement of 10.5%. The total capital to risk-weighted assets ratio came in at 21.1%, exceeding the statutory requirement of 14.5% by 6.6% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 20.0%, while total capital to risk-weighted assets came in at 21.1%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.2%, and a Return on Average Equity (ROaE) of 8.0%.

Key Take-Outs:

1. **Deteriorating Asset Quality** – The group’s asset quality deteriorated, with the NPL ratio increasing to 12.7% in Q3’2022, from 11.9% in Q3’2021, owing to the 28.1% growth in gross non-performing loans, which outpaced the 18.5% increase in net loans and advances to Kshs 243.7 bn, from Kshs 205.6 bn in Q3’2021. The increase in NPLs can be attributed to the increase in credit risk in the Kenya’s banking sector, with sector’s gross NPLs to gross loans ratio increasing to 14.7% in Q2’2022 from 14.0% in Q1’2022

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

I. **Branch Expansion**: The bank’s continued opening of new branches across the country will see it increase its footprint and access to many customers within the country. As part of its growth initiative, the bank is expected to open 17 new branches within Kenya by end of 2022. In the long term, the expansion strategy is expected to increase its market, thus increasing its profitability, and,

II. **Digitization**: Through its agile digital platforms, the bank has been able to have majority of the bank’s transactions done through mobile transactions. Additionally, Kshs 3.5 bn is geared to be invested in digital transformation in 2022-2024 with Kshs 2.4 bn already invested in 2018-2021. The continued leverage on technology to improve customer experience is expected to expedite service delivery to its customers

Valuation Summary

- We are of the view that DTB-K is an “ACCUMULATE” with a target price of Kshs 54.4, representing an upside of 15.7%, from the current price of Kshs 47.0 as of 25th November 2022,
- DTB-K is currently trading at a P/TBV of 0.2x and a P/E of 2.4x vs an industry average of 0.9x and 4.0x, respectively.