Diamond Trust Bank Kenya – FY'2020
26th March, 2021

Valuation Summary

- We are of the view that Diamond Trust Bank Kenya is a **"BUY"** with a target price of Kshs 114.2, representing an upside of 71.8%, from the current price of Kshs 66.5 as of 26th March 2020,
- Diamond Trust Bank Kenya is currently trading at a P/TBV of 0.3x and a P/E of 4.1x vs an industry average of 1.0x and 7.8x, respectively.

Key Highlights FY'2020

- In FY'2020, DTB-K rolled out various interventions to help businesses remain afloat during the COVID-19 pandemic including the Kshs 100.0 mn donated to Covid-19 emergency relief programs and the Kshs 50.0 mn donation signed with International Finance Corporation (IFC) for onward lending to Micro, Small and Medium Enterprises (MSMEs). In addition, the bank donated an extra Kshs 1.6 bn in COVID-19 recovery for SMEs earlier this year,
- DTB-K also granted repayment holidays to its borrowers owing to the sudden and severe cash flow constraints that many of its borrowers were experiencing which saw the bank restructure repayment terms for existing loan facilities totaling Kshs 101.0 bn, accounting for more than 45.0% of the group's loan portfolio,

Income Statement

- The bank's core earnings per share declined by 51.5% to Kshs 12.6, from Kshs 26.0 in FY'2019, a faster decline than our expectation of a 36.6% decline to Kshs 16.5 per share. The bank's performance was driven by the 48.7% increase in total operating expenses, which outpaced the 1.1% decline in total operating income to Kshs 24.2 bn from Kshs 24.5 bn in FY'2019. The variance in the core earnings per share decline against our expectation was mainly attributable to the 453.6% increase in Loans Loss Provision(LLP) to Kshs 7.3 bn, from Kshs 1.3 bn recorded in FY'2019, against our expectations of a 24.7% decline to Kshs 4.5 bn in FY'2019,
- Total operating income declined by 1.1% to Kshs 24.2 bn, from Kshs 24.5 bn in FY'2019 mainly driven by a 3.4% decline in the Net Interest Income (NII) to Kshs 18.1 bn, from Kshs 18.7 bn in FY'2019. The decline was however mitigated by a 6.1% growth in Non-Funded Income (NII) to Kshs 6.1 bn, from Kshs 5.8 bn in FY'2019,
- Interest income declined by 5.4% to Kshs 31.1 bn, from Kshs 32.9 bn in FY'2019. This was driven by a 7.0% decline in interest income from loans and advances to Kshs 18.5 bn, from Kshs 20.0 bn in FY'2019, coupled with the 1.0% decline in Interest income from government securities to Kshs 12.4 bn from Kshs 12.5 bn in FY'2019. Interest income from deposit placements also declined by 57.5% to Kshs 169.2 mn, from Kshs 398.4 mn in FY'2019. The Yield on Interest-Earning Assets declined to 8.7% from 9.9% in FY'2019, attributable to the 10.9% increase in average interest-earning assets to Kshs 376.9 bn, from Kshs 339.9 bn in FY'2019, coupled with the 5.4% decline in trailing interest income,
- Interest expense declined by 8.0% to Kshs 13.0 bn, from Kshs 14.1 bn in FY'2019, following a 7.6% decline in interest expense on customer deposits to Kshs 11.2 bn, from Kshs 12.1 bn in FY'2019 coupled with an 11.4% decline in interest expense on placement liabilities to Kshs 563.4 mn, from Kshs 635.9 mn in FY'2019. Cost of funds, declined to 3.9% from 4.5% in FY'2019, owing to the 8.0% decline in interest expenses coupled with 10.8% growth in interest-bearing liabilities, an indication that the bank managed to mobilize cheaper deposits. Net Interest Margin (NIM) declined to 5.0%, from 5.6% in FY'2019 due to the faster 7.9% growth in average interest-earning assets which outpaced the 5.4% decline in interest income,

- Non-Funded Income (NFI) rose by 6.1% to Kshs 6.1 bn, from Kshs 5.8 bn in FY'2019. The increase was mainly driven by the 7.1% increase in fees and commissions on loans to Kshs 1.4 bn from Kshs 1.3 bn recorded in FY'2019 coupled with a 7.1% growth in the foreign exchange trading income to Kshs 2.3 bn, from Kshs 1.8 bn in FY'2019. The growth in NFI was however weighed down by a 16.8% decline in other fees to Kshs 1.8 bn, from Kshs 2.2 bn in FY'2019. Notably, total fees and commissions declined by 31.5% to Kshs 3.3 bn, from Kshs 3.6 bn, attributable to the waiver on bank fees and transactions seen during the year. As a result, the revenue mix shifted to 75:25 from 76:24 funded to non-funded income, owing to the 6.1% growth in NFI as compared to the 3.4% decline in NII,
- Total operating expenses rose by 48.7% to Kshs 19.7 bn, from Kshs 13.2 bn in FY'2019, largely driven by the 453.6% increase in Loan Loss Provisions (LLP) to Kshs 7.3 bn from Kshs 1.3 bn in FY'2019 on the back of the subdued operating environment seen during the year. Staff costs increased by 1.1% to Kshs 4.72 bn from Kshs 4.67 bn in FY'2019. Additionally, Other operating expenses increased by 5.4% to Kshs 7.6 bn from Kshs 7.2 bn recorded in FY'2019,
- Cost to Income Ratio (CIR) deteriorated to 81.3%, from 54.0% in FY'2019 owing to the 48.7% increase in operating expenses Kshs 19.7 bn, from Kshs 13.2 bn in FY'2019 which outpaced the 1.1% decline in operating income to Kshs 24.2 bn, from Kshs 24.5 bn in FY'2019. Without LLP, the cost to income ratio deteriorated as well to 51.0%, from 48.6% in FY'2019, highlighting a decline in efficiency levels,
- Profit before tax fell by 58.6% to Kshs 4.7 bn, from Kshs 11.3 bn in FY'2019. Profit after tax declined by 51.5% to Kshs 3.5 bn in FY'2020, from Kshs 7.3 bn recorded in FY'2019, with the effective tax rate decreasing to 24.4%, from 35.5% in FY'2019, and,
- The Board of Directors did not recommend a dividend for the year attributable to the poor operating environment in FY'2020 brought about by the pandemic that led to a 51.5% decline in the Profit after tax, coupled with the need to preserve cash flows to caution against any further effects,

<u>Balance Sheet</u>

- The balance sheet recorded an expansion as Total Assets increased by 10.1% to Kshs 425.1 bn, from Kshs 386.2 bn recorded in FY'2019. This growth was largely driven by a 12.0% increase in government securities to Kshs 148.4 bn, from Kshs 132.5 bn in FY'2019, coupled with a 4.8% increase in net loans to Kshs 208.6 bn, from Kshs 199.1 bn in FY'2019. The increased allocation in government securities was mainly on the back of the lender's cautious lending amid the elevated credit risk amid the pandemic,
- Total liabilities grew by 10.9% to Kshs 356.7 bn, from Kshs 321.7 bn in FY'2019, driven by a 74.3% increase in borrowings to Kshs 19.8 bn from Kshs 11.4 bn in FY'2019, attributable to the additional debts the bank acquired to finance its operations and boost liquidity, coupled with a 6.4% increase in customer deposits to Kshs 298.2 bn from Kshs 280.2 bn in FY'2019. Deposits per branch increased by 6.4% to Kshs 2.2 bn from Kshs 2.0 bn, as the number of branches remained unchanged at 137 in FY'2020. However, the number of branches is set to decline as the bank plans to shut down six branches by the end of October 2021 owing to its rising operational costs,
- Loans to deposit ratio declined to 70.0%, from 71.1% in FY'2019, owing to the faster 6.4% growth in deposits, compared to the 4.8% growth in the net loans during the period,
- Gross Non-Performing Loans (NPLs) rose by 43.1% to Kshs 22.8 bn in FY'2020, from Kshs 15.9 bn recorded in FY'2019. Consequently, the NPL ratio deteriorated to 10.4% from 7.7% recorded in FY'2019, due to the faster 43.1% growth in gross NPLs which outpaced the 6.4% growth in gross loans,
- General Loan Loss Provisions increased by 113.4% to Kshs 9.6 bn from Kshs 4.5 bn in FY'2019. Consequently, the NPL coverage (having added interest in suspense) increased to 44.6% in FY'2020, from

42.9% in FY’2019, owing to the faster 113.4% increase in general provisions, which outpaced the 43.1% growth in Gross NPLs,

- Shareholders’ funds increased by 5.3% to Kshs 62.0 bn in FY’2020, from Kshs 58.9 bn largely due to the 7.4% increase in the retained earnings to Kshs 51.0 bn, from Kshs 47.5 bn in FY’2019,
- Diamond Trust Bank is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 20.7%, 10.2% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 22.5%, exceeding the 14.5% statutory requirement by 8.0% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 21.0%, while total capital to risk-weighted assets came in at 22.7%, and,
- The bank currently has a Return on Average Assets (ROaA) of 0.6%, and a Return on Average Equity (ROaE) of 5.8%.

Key Take-Outs:

1. **Asset Quality** - The bank’s asset quality deteriorated, with the NPL ratio increasing to 10.4% in FY’2020, from 7.7% in FY’2019, due to the faster 43.1% growth in gross NPLs, which outpaced the 6.4% 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 4.8% to Kshs 208.6 bn, from Kshs 199.1 bn in FY’2019. The muted growth in the loan book is as a result of the bank’s continuous selective lending to prevent further erosion of the asset quality, and,
2. **Revenue Diversification** - The bank recorded an improved performance on the NFI income segment, which rose by 6.1% to Kshs 6.1 bn, from Kshs 5.8 bn in FY’2019. The increase was mainly driven by the 34.2% increase in other income to Kshs 525.9 mn, from Kshs 392.0 mn in FY’2019, coupled with 27.1% growth in the foreign exchange trading income to Kshs 2.3 bn from Kshs 1.8 bn in FY’2019. As a result, 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 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	FY’2019	FY’2020	y/y change	FY’2020e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	132.5	148.4	12.0%	134.8	1.8%	10.2%
Net Loans and Advances	199.1	208.6	4.8%	203.7	2.3%	2.4%
Total Assets	**386.2**	**425.1**	**10.1%**	**390.5**	**1.1%**	**8.9%**
Customer Deposits	280.2	298.2	6.4%	285.2	1.8%	4.6%
Total Liabilities	321.7	356.7	10.9%	321.8	0.0%	10.9%
Shareholders’ Funds	**58.9**	**62.0**	**5.3%**	**62.4**	**6.1%**	**(0.8%)**

Balance Sheet Ratios	FY'2019	FY'2020	y/y change
Loan to Deposit Ratio	71.1%	70.0%	(1.1%)
Return on average equity	13.4%	5.8%	(7.6%)
Return on average assets	1.4%	0.6%	(0.8%)

Income Statement	FY19	FY20	y/y change	FY'2020f	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	18.7	18.1	(3.4%)	16.0	(14.5%)	11.1%
Net non-Interest Income	5.8	6.1	6.1%	5.8	0.3%	5.8%
Total Operating income	**24.5**	**24.2**	**(1.1%)**	**21.8**	**(11.0%)**	**9.8%**
Loan Loss provision	1.3	7.3	453.6%	4.5	241.7%	211.9%
Total Operating expenses	13.2	19.7	48.7%	14.8	11.8%	37.0%
Profit before tax	**11.3**	**4.7**	**(58.6%)**	**7.0**	**(37.6%)**	**(21.0%)**
Profit after tax	**7.3**	**3.5**	**(51.5%)**	**4.6**	**(36.6%)**	**(14.8%)**
Core EPS	**26.0**	**12.6**	**(51.5%)**	**16.5**	**(36.6%)**	**(14.8%)**

Income Statement Ratios	FY'2019	FY'2020	% point change
Yield from interest-earning assets	9.9%	8.7%	(1.2%)
Cost of funding	4.5%	3.9%	(0.6%)
Net Interest Spread	5.4%	4.7%	(0.7%)
Net Interest Income as % of operating income	76.4%	74.7%	(1.7%)
Non-Funded Income as a % of operating income	23.6%	25.3%	1.7%
Cost to Income Ratio (CIR)	54.0%	81.3%	27.3%
CIR without LLP	48.6%	51.0%	2.4%
Cost to Assets	3.5%	4.8%	1.3%
Net Interest Margin	5.6%	5.0%	(0.6%)

Capital Adequacy Ratios	FY19	FY20
Core Capital/Total Liabilities	22.3%	22.8%
Minimum Statutory ratio	8.0%	8.0%
Excess	14.3%	14.8%
Core Capital/Total Risk Weighted Assets	19.1%	20.7%
Minimum Statutory ratio	10.5%	10.5%
Excess	8.6%	10.2%
Total Capital/Total Risk Weighted Assets	20.9%	22.5%
Minimum Statutory ratio	14.5%	14.5%

Excess	6.4%	8.0%
Liquidity Ratio	54.8%	56.0%
Minimum Statutory ratio	20.0%	20.0%
Excess	**34.8%**	**36.0%**
Adjusted Core Capital/Total Liabilities	**23.4%**	**23.3%**
Adjusted Core Capital/Total RWA	**21.0%**	**19.9%**
Adjusted Total Capital/Total RWA	**22.7%**	**21.8%**