Diamond Trust Bank Kenya – H1’2022

26th August, 2022

Below is a summary of Diamond Trust Bank - Kenya’s H1’2022 performance:

Balance Sheet Items	H1’2021	H1’2022	y/y change
Government Securities	134.8	129.0	(4.3%)
Net Loans and Advances	204.3	233.6	14.3%
Total Assets	**429.6**	**485.0**	**12.9%**
Customer Deposits	313.8	346.5	10.4%
Deposits per Branch	2.3	2.7	14.7%
Total Liabilities	357.4	408.4	14.3%
Shareholders’ Funds	**65.4**	**68.9**	**5.4%**

Balance Sheet Ratios	H1’2021	H1’2022	% Points change
Loan to Deposit Ratio	65.1%	67.4%	2.3%
Return on average equity	6.4%	7.8%	1.4%
Return on average assets	1.0%	1.1%	0.1%

Income Statement	H1’2021	H1’2022	y/y change
Net Interest Income	9.8	11.1	13.3%
Net non-Interest Income	3.3	3.9	17.8%
Total Operating income	**13.1**	**15.0**	**14.5%**
Loan Loss provision	2.3	2.4	5.2%
Total Operating expenses	**8.3**	**9.4**	**13.4%**
Profit before tax	**4.88**	**5.62**	**15.2%**
Profit after tax	**3.2**	**4.0**	**25.6%**
Core EPS	**11.27**	**14.15**	**25.6%**

Income Statement Ratios	H1’2021	H1’2022	% points change
Yield from interest-earning assets	8.7%	8.8%	0.1%
Cost of funding	2.1%	2.1%	-
Net Interest Spread	6.6%	6.8%	0.2%
Net Interest Income as % of operating income	74.7%	74.0%	(0.7%)
Non-Funded Income as a % of operating income	25.3%	26.0%	0.7%
Cost to Income Ratio (CIR)	62.9%	62.3%	(0.6%)
CIR without provisions	45.3%	46.1%	0.8%
Cost to Assets	4.9%	4.6%	(0.3%)
Net Interest Margin	5.0%	5.2%	0.2%

Capital Adequacy Ratios	H1’2021	H1’2022	% Points Change
Core Capital/Total Liabilities	22.5%	21.7%	(0.8%)
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess	14.5%	13.7%	(0.8%)
Core Capital/Total Risk Weighted Assets	21.3%	20.0%	(1.3%)
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess	10.8%	9.5%	(1.3%)
Total Capital/Total Risk Weighted Assets	22.8%	21.2%	(1.6%)
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess	8.3%	7.6%	(0.7%)
Liquidity Ratio	60.3%	58.9%	(1.4%)
Minimum Statutory ratio	20.0%	20.0%	0.0%
Excess	**40.3%**	**38.9%**	**(1.4%)**

Adjusted Core Capital/Total Liabilities	**22.9%**	**21.7%**	**(1.2%)**
Adjusted Core Capital/Total RWA	**21.7%**	**20.0%**	**(1.7%)**
Adjusted Total Capital/Total RWA	**23.2%**	**21.2%**	**(2.0%)**

Income Statement

- The bank’s core earnings per share increased by 25.6% to Kshs 14.2, from Kshs 11.3 in H1’2021, lower than our expectations of a 39.6% increase. The bank’s performance was driven by the 14.5% increase in total operating income to Kshs 15.0 bn, from Kshs 13.1 bn in H1’2021, which outpaced the 13.4% increase in total operating expenses to Kshs 9.4 bn from Kshs 8.3 bn in H1’2021,
- Total operating income increased by 14.5% to Kshs 15.0 bn, from Kshs 13.1 bn in H1’2021 mainly driven by a 13.3% increase in the Net Interest Income (NII) to Kshs 11.1 bn, from Kshs 9.8 bn in H1’2021, coupled with a 17.8% growth in Non-Funded Income (NFI) to Kshs 3.9 bn, from Kshs 3.3 bn in H1’2021,
- Interest income increased by 12.5% to Kshs 18.8 bn, from Kshs 16.7 bn in H1’2021, driven by a 22.4% increase in interest income from government securities to Kshs 8.8 bn, from Kshs 7.2 bn in H1’2021, coupled with a 4.7% increase in Interest income from loans and advances to Kshs 9.9 bn from Kshs 9.4 bn in H1’2021. Consequently, the Yield on Interest-Earning Assets increased by 0.1% point to 8.8% in H1’2022, from 8.7%, in H1’2021, attributable to the 12.5% increase in trailing interest income, which outpaced the 10.3% growth in average interest-earning assets. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expenses increased by 11.4% to Kshs 7.7 bn, from Kshs 6.9 bn in H1’2021, following an 11.9% increase in interest expense on customer deposits to Kshs 6.8 bn, from Kshs 6.1 bn in H1’2021. Cost of funds remained unchanged at 2.1% as recorded in H1’2021, owing to the 9.8% increase in trailing interest expenses, coupled with 7.9% growth in average interest-bearing liabilities. However, the Net Interest Margin (NIM) increased by 0.2% points to 5.2%, from 5.0% in H1’2021 due to the faster 14.5% growth in trailing Net Interest Income, compared to the 10.3% growth seen in the average interest-earning assets,
- Non-Funded Income (NFI) rose by 17.8% to Kshs 3.9 bn, from Kshs 3.3 bn in H1’2021. The increase was mainly driven by the 56.8% increase in foreign exchange trading income to Kshs 1.9 bn from Kshs 1.2 bn recorded in H1’2021 following the continued depreciation of the local currency. Total fees and commissions increased by 9.4% to Kshs 1.8 bn, from Kshs 1.6 bn, in H1’2021,
- Total operating expenses rose by 13.4% to Kshs 9.4 bn from Kshs 8.3 bn in H1’2021, largely driven by a 19.1% increase in staff costs to Kshs 2.9 bn from Kshs 2.4 bn in H1’2021, given the group’s physical expansion which necessitates hiring of more staff. Other operating expenses also increased by 14.7% to Kshs 4.1 bn from Kshs 3.5 bn in H1’2021. Notably, Loan Loss Provision increased by 5.2% to Kshs 2.4 bn from Kshs 2.3 bn recorded in H1’2021, following the slowdown in business activity that poses uncertainty,
- Cost to Income Ratio (CIR) declined to 62.3%, from 62.9% in H1’2021 owing to the 14.5% increase in total operating income, which outpaced the 13.4% increase in total operating expenses. Without LLP, the cost to income ratio deteriorated to 46.1%, from 45.3% in H1’2021, highlighting reduced efficiency levels, and,
- Profit before tax rose by 15.2% to Kshs 5.6 bn, from Kshs 4.9 bn in H1’2021. Similarly, profit after tax increased by 25.6% to Kshs 4.0 bn in H1’2022, from Kshs 3.2 bn recorded in H1’2021, with the effective tax rate declining to 29.6%, from 35.4% in H1’2021.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 12.9% to Kshs 485.0 bn, from Kshs 429.6 bn recorded in H1’2021. The growth was largely driven by a 14.3% increase in net loans to Kshs 233.6

bn, from Kshs 204.3 bn in H1’2021. The performance was however weighed down by a 4.3% decline in government securities which came in at Kshs 129.0 bn, from Kshs 134.8 bn in H1’2021,

- Total liabilities grew by 14.3% to Kshs 408.4 bn, from Kshs 357.4 bn in H1’2021, driven by a 10.4% increase in customer deposits to Kshs 346.5 bn from Kshs 313.8 bn in H1’2021, coupled with an 85.6% increase in placements to Kshs 27.8 bn, from Ksh 15.0 bn, in H1’2021. Deposits per branch increased by 14.7% to Kshs 2.7 bn from Kshs 2.3 bn, as the number of branches declined to 129 in H1’2022 from 134 branches in H1’2021 after the Group closed 6 branches in Kenya, that were in close proximity, but opened 1 branch in Uganda. In FY’2022, the Group plans on opening 20 more branches and has already opened 3 in the Nairobi region as of July 2022,
- Loans to deposit ratio rose to 67.4%, from 65.1% in H1’2021, owing to the faster 14.3% growth in Net Loans compared to the 10.4% growth in the deposits during the period,
- Gross Non-Performing Loans (NPLs) rose by 43.0% to Kshs 31.8 bn in H1’2022, from Kshs 22.2 bn recorded in H1’2021. Consequently, the NPL ratio deteriorated to 12.8% from 10.4% recorded in H1’2021, due to the faster 43.0% growth in gross NPLs which outpaced the 16.0% growth in gross loans. The increasing NPLs can be attributed to the bank’s exposure to trade and real estate which are yet to fully recover from the effects of the pandemic,
- General Provisions increased by 41.5% to Kshs 12.3 bn from Kshs 8.7 bn in H1’2021, resulting to an increase in NPL coverage (having added interest in suspense) to 44.2% in H1’2022, from 41.8% in H1’2021, owing to the faster 43.0% increase in Gross NPLs, which outpaced the growth in general provisions,
- Shareholders’ funds increased by 5.4% to Kshs 68.9 bn in H1’2022, from Kshs 65.4 bn largely due to the 7.1% increase in the retained earnings to Kshs 58.2 bn, from Kshs 54.4 bn in H1’2021,
- Diamond Trust Bank is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 20.0%, 9.5% points above the statutory requirement of 10.5%. Additionally, the total capital to risk-weighted assets ratio was 21.2%, exceeding the 14.5% statutory requirement by 7.6% 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 21.2%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.1%, and a Return on Average Equity (ROaE) of 7.8%.

Key Take-Outs:

1. **Deteriorating Asset Quality** - The bank’s asset quality deteriorated, with the NPL ratio increasing to 12.8% from 10.4% recorded in H1’2021, due to the faster 43.0% growth in gross NPLs which outpaced the 16.0% growth in gross loans. The increased NPLs can be attributed to the fact that the bank lends mostly to the trade, real estate, manufacturing and tourism sectors which are yet to recover from the pandemic effects. The four sectors contributed a total of 87.1% of their NPLs as of December 2021. However, it is worth noting that the group’s loan book continues to expand gradually having grown by 14.3% compared to the 9.2% growth in Q1’2022, an indication of a gradual resumption to lending on the back of declining credit risk in the business environment, and,
2. **Increasing Operating Expenses** - The bank’s operating efficiency declined as evidenced by the increase in cost to income ratio without LLP to 46.1%, from 45.3% in H1’2022. This can be attributed to the continued increase in staff costs, having increased by 19.1% in H1’2021 as the Group embarks on expanding its network and focusing on branch transformation. We expect staff costs and other operating expenses to increase further as the bank is set to open 17 more branches in Kenya by the end of 2022. In the long term, we expect to see the strategy give back to the group as per the strategy.

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

I. **Digital platforms** - The bank intends to expedite its digital transformation agenda and leverage on the strategy in improving their customer experience. Further, the Group is set to invest Kshs 3.5 bn in technology between 2022 and 2023 to expand its digital lending footprints, having already invested Kshs 2.4 bn between 2018 and 2021.

Valuation Summary

- We are of the view that Diamond Trust Bank Kenya is an **"ACCUMULATE"** with a target price of Kshs 58.3, representing an upside of 13.2%, from the current price of Kshs 51.5 as of 26th August 2022,
- Diamond Trust Bank Kenya is currently trading at a P/TBV of 0.2x and a P/E of 3.3x vs an industry average of 0.8x and 4.2x, respectively.