Diamond Trust Bank Kenya – Q1'2022

27th May, 2022

Below is a summary of Diamond Trust Bank - Kenya's Q1'2022 performance:

Balance Sheet Items	Q1'2021	Q1'2022	y/y change
Government Securities	113.9	127.7	12.1%
Net Loans and Advances	205.8	224.8	9.2%
Total Assets	**417.3**	**471.3**	**12.9%**
Customer Deposits	301.8	343.1	13.7%
Total Liabilities	**346.9**	**394.7**	**13.8%**
Shareholders' Funds	**64.0**	**69.1**	**8.0%**

Balance Sheet Ratios	Q1'2021	Q1'2022	% Points change
Loan to Deposit Ratio	68.2%	65.5%	(2.7%)
Return on average equity	5.7%	7.1%	1.4%
Return on average assets	0.9%	1.1%	0.2%

Income Statement	Q1'2021	Q1'2022	y/y change
Net Interest Income	5.0	5.5	11.6%
Net non-Interest Income	1.6	1.8	14.1%
Total Operating income	**6.5**	**7.3**	**12.2%**
Loan Loss provision	0.7	0.6	(14.9%)
Total Operating expenses	**3.5**	**3.9**	**10.7%**
Profit before tax	3.0	3.4	13.2%
Profit after tax	**2.1**	**2.4**	**16.3%**
Core EPS	**7.3**	**8.5**	**16.3%**

Income Statement Ratios	Q1'2021	Q1'2022	% points change
Yield from interest-earning assets	8.9%	8.9%	-
Cost of funding	4.0%	3.9%	(0.1%)
Net Interest Spread	4.9%	5.0%	0.1%
Net Interest Income as % of operating income	76.1%	75.7%	(0.4%)
Non-Funded Income as a % of operating income	23.9%	24.3%	0.4%
Cost to Income Ratio (CIR)	54.0%	53.2%	(0.7%)
CIR without provisions	43.5%	45.3%	1.8%
Cost to Assets	5.0%	4.6%	(0.4%)
Net Interest Margin	5.2%	5.3%	0.1%

Capital Adequacy Ratios	Q1'2021	Q1'2022	% Points Change
Core Capital/Total Liabilities	22.8%	21.7%	(1.1%)
Minimum Statutory ratio	8.0%	8.0%	-
Excess	14.8%	13.7%	(1.1%)
Core Capital/Total Risk Weighted Assets	20.8%	20.5%	(0.3%)
Minimum Statutory ratio	10.5%	10.5%	-
Excess	10.3%	10.0%	(0.3%)
Total Capital/Total Risk Weighted Assets	22.4%	21.8%	(0.6%)
Minimum Statutory ratio	14.5%	14.5%	-
Excess	7.9%	7.3%	(0.6%)
Liquidity Ratio	58.7%	58.3%	(0.4%)
Minimum Statutory ratio	20.0%	20.0%	-
Excess	**38.7%**	**38.3%**	**(0.4%)**
Adjusted Core Capital/Total Liabilities	**23.3%**	**21.8%**	**(1.5%)**

Adjusted Core Capital/Total RWA	**21.3%**	**20.6%**	**(0.7%)**
Adjusted Total Capital/Total RWA	**22.9%**	**21.8%**	**(1.1%)**

Income Statement

- The bank's core earnings per share increased by 16.3% to Kshs 8.5, from Kshs 7.3 in Q1'2021, lower than our expectations. The bank's performance was driven by the 12.2% increase in total operating income to Kshs 7.3 bn, from Kshs 6.5 bn in Q1'2021, which outpaced the 10.7% increase in total operating expenses to Kshs 3.9 bn from Kshs 3.5 bn in Q1'2021,
- Total operating income increased by 12.2% to Kshs 7.3 bn, from Kshs 6.5 bn in Q1'2021 mainly driven by an 11.6% increase in the Net Interest Income (NII) to Kshs 5.0 bn, from Kshs 5.5 bn in Q1'2021, coupled with a 14.1% growth in Non-Funded Income (NFI) to Kshs 1.8 bn, from Kshs 1.6 bn in Q1'2021,
- Interest income increased by 10.7% to Kshs 9.2 bn, from Kshs 8.3 bn in Q1'2021. This was driven by a 23.0% increase in interest income from government securities to Kshs 4.3 bn, from Kshs 3.5 bn in Q1'2021, coupled with a 1.5% increase in Interest income from loans and advances to Kshs 4.84 bn from Kshs 4.77 bn in Q1'2021. Interest income from deposit placements also increased by 20.3% to Kshs 50.4 mn, from Kshs 41.9 mn in Q1'2021. The Yield on Interest-Earning Assets remained unchanged at 8.9% in Q1'2022 similar to what was recorded in Q1'2021, attributable to a similar 10.7% growth in trailing interest income as in 10.1% % growth in average interest-earning assets to Kshs 391.1 bn, from Kshs 340.9 bn in Q1'2021,
- Interest expense increased by 9.5% to Kshs 3.7 bn, from Kshs 3.4 bn in Q1'2021, following a 13.5% increase in interest expense on customer deposits to Kshs 3.3 bn, from Kshs 2.9 bn in Q1'2021. The increase was however mitigated by a 5.7% decline in other interest expenses to Kshs 270.3 mn, from Kshs 286.5 mn in Q1'2021. Cost of funds reduced marginally to 3.9% in Q1'2022 from 4.0% recorded in Q1'2021, owing to the slower 8.6% increase in trailing interest expenses, compared to the 11.1% growth in average interest-bearing liabilities to Kshs 360.6 bn, from Kshs 324.7 bn. Net Interest Margin (NIM) marginally increased by 0.1% point to 5.3%, from 5.2% in Q1'2021 due to the faster 12.0% growth in trailing Net Interest Income, compared to the 10.1% growth seen in the average interest-earning assets,
- Non-Funded Income (NFI) rose by 14.1% to Kshs 1.8 bn, from Kshs 1.6 bn in Q1'2021. The increase was mainly driven by the 10.2% increase in foreign exchange trading income to Kshs 773.1 mn from Kshs 701.5 mn recorded in Q1'2021, coupled with a 16.4% increase in other fees to Kshs 555.1 mn, from Kshs 476.8 mn in Q1'2021. Notably, total fees and commissions increased by 10.0% to Kshs 869.7 mn, from Kshs 790.4 mn, in Q1'2021. The revenue mix remained unchanged at 76:24 funded to non-funded income, as was recorded in Q1'2021,
- Total operating expenses rose by 10.7% to Kshs 3.9 bn from Kshs 3.5 bn in Q1'2021, largely driven by the 17.0% increase in staff costs to Kshs 1.4 bn from Kshs 1.2 bn in Q1'2021, coupled with 16.7% increase in other operating expenses to Kshs 1.9 bn from Kshs 1.6 bn in Q1'2021. However, Loan Loss Provision declined by 14.9% to Kshs 0.6 bn from Kshs 0.7 bn recorded in Q1'2021,
- Cost to Income Ratio (CIR) declined to 53.2%, from 54.0% in Q1'2021 owing to the 12.2% increase in total operating income to Kshs 7.3 bn, from Kshs 6.5 bn in Q1'2021, which outpaced the 10.7% increase in total operating expenses to Kshs 3.9 bn from Kshs 3.5 bn in Q1'2021. Without LLP, the cost to income ratio deteriorated to 45.3%, from 43.5% in Q1'2021, highlighting reduced efficiency levels, and,
- Profit before tax rose by 13.2% to Kshs 3.4 bn, from Kshs 3.0 bn in Q1'2021. Profit after tax increased by 16.3% to Kshs 2.4 bn in Q1'2022, from Kshs 2.1 bn recorded in Q1'2021, with the effective tax rate declining to 29.5%, from 31.4% in Q1'2021.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 12.9% to Kshs 471.3 bn, from Kshs 417.3 bn recorded in Q1'2021. The growth was largely driven by a 9.2% increase in net loans to Kshs 224.8 bn, from Kshs 205.8 bn in Q1'2021 coupled with a 12.1% increasein government securities to Kshs 127.7 bn, from Kshs 113.9 bn in Q1'2021,

- Total liabilities grew by 13.8% to Kshs 394.7 bn, from Kshs 346.9 bn in Q1'2021, driven by a 13.7% increase in customer deposits to Kshs 343.1 bn from Kshs 301.8 bn in Q1'2021, coupled with a 62.2% increase in placements to Kshs 23.8 bn, from Ksh 14.7 bn, in Q1'2021. Customer deposits increased as well by 12.9% to Kshs 845.8 bn, from Kshs 749.4 bn, with customer deposits from NBK amounting to Kshs 98.7 bn in Q1'2022. Deposits per branch increased by 18.1% to Kshs 2.7 bn from Kshs 2.3 bn, as the number of branches declined to 129 in Q1'2022 from 134 branches in Q1'2021 after the Group closed 6 branches in Kenya, in order to reduce operational costs, but opened 1 branch in Uganda. In FY'2022, the Group plans on opening 20 more branches and an additional 20 by 2024, in a bid to expand their network coverage,
- Loans to deposit ratio declined to 65.5%, from 68.2% in Q1'2021, owing to the faster 13.7% growth in deposits, compared to the 9.2% growth in the net loans during the period,
- Gross Non-Performing Loans (NPLs) rose by 30.7% to Kshs 30.0 bn in Q1'2022, from Kshs 22.9 bn recorded in Q1'2021. Consequently, the NPL ratio deteriorated to 12.6% from 10.6% recorded in Q1'2021, due to the faster 30.7% growth in gross NPLs which outpaced the 9.7% growth in gross loans,
- General Loan Loss Provisions increased by 11.1% to Kshs 11.2 bn from Kshs 10.1 bn in Q1'2021. The NPL coverage (having added interest in suspense) declined to 42.2% in Q1'2022, from 46.5% in Q1'2021, owing to the faster 30.7% increase in Gross NPLs, which outpaced the 11.1% growth in general provisions,
- Shareholders' funds increased by 8.1% to Kshs 69.1 bn in Q1'2022, from Kshs 64.0 bn largely due to the 6.4% increase in the retained earnings to Kshs 56.8 bn, from Kshs 53.4 bn in Q1'2021,
- Diamond Trust Bank is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 20.5%, 10.0% points above the statutory requirement of 10.5%. Additionally, the total capital to risk-weighted assets ratio was 21.8%, exceeding the 14.5% statutory requirement by 7.3% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 20.6%, while total capital to risk-weighted assets came in at 21.8%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.1%, and a Return on Average Equity (ROaE) of 7.1%.

Key Take-Outs:

1. **Asset Quality** - The bank's asset quality deteriorated, with the NPL ratio increasing to 12.6% from 10.6% recorded in Q1'2021, due to the faster 30.7% growth in gross NPLs which outpaced the 9.7% 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 9.9% compared to the 5.7% growth in FY'2021, an indication of a gradual resumption to lending on the back of declining in credit risk in the business environment, and,
2. **Operating Efficiency** - The bank's operating efficiency declined as evidenced by the increase in cost to income ratio without LLP to 45.3%, from 43.5% in Q1'2021, which indicates increased operational costs and reduced operational efficiency. This can be attributed to the 17.0% increase in staff costs to Kshs 1.4

bn from Kshs 1.2 bn in Q1'2021 as the Group focus on establishing its business print by expanding its network. We expect staff costs and other operating expenses to increase further as the bank is set to open 20 more branches in Kenya in FY'2022.

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 56.8, representing an upside of 13.7%, from the current price of Kshs 50.0 as of 27th May 2022,
- Diamond Trust Bank Kenya is currently trading at a P/TBV of 0.2x and a P/E of 2.9x vs an industry average of 0.8x and 3.9x, respectively.