November, 12 2021

RECOMMENDATION

BUY

BK GROUP PLC (Rwanda)

Target Price FRW 364

Return Potential: +46% on RSE, +40% on NSE

Takeaways from the 3Q21 results; healthy balance sheet growth, non-interest income boosts profitability into top gear, dividend announcements welcome; reiterate Buy

BK Group PLC ("BK") on November 5th 2021 reported a notably strong quarter with net profit coming in +14% ahead of our estimates. This remarkable performance was underscored by lower-than-expected provisions (-10% vs *BKCe*) and higher non-funded income which came in 10% above our expectations. BK delivered a reported Return on average Equity of 18.2%, and is firmly on the path to achieving RoAEs of 20% by FY 24E which we expect will drive its valuations higher, further narrowing the gap with Kenyan Banks listed on the Nairobi Securities Exchange.

Our key takeaways from the call are summarised as below:

- **Volume growth**. Total loan growth increased +21% y/y (+7.9% q/q), generally driven by an acceleration in lending to large corporates +20% ytd (c.76% of gross loans outstanding) and recovery in lending to SME's +17% ytd, (c.14% of gross loans). Lending to retail (c.10% of gross loans) remains muted at c.+2% growth ytd, though we do expect to see some improvement as the NPL stock in the retail segment declines further. The overall credit picture remains healthy despite recent macro concerns around increased fiscal spending and tightening liquidity in the interbank markets, and we continue to expect strong double digit loan growth at year end, and an improving loan mix in FY22-23E.

  BK's liability franchise continues to strengthen, having grown industry deposit market share from 35.7% to 36.2% as at 9M21 with Frw 137Bn in deposits collected ytd. Customer Deposits have increased +20% y/y (+8% q/q), driven primarily by large corporate deposit inflows +40%. Retail deposits picked up a healthy +10% ytd.

- **Asset Quality**. Asset quality trends improved over the period, with NPLs decreasing 50bps ytd which was slightly better performance than estimated. By segment, NPLs in the Corporate book increased by 80bps to 3% of Loans, while the SME and Retail segments saw moderate improvements of -310bps (to 22%) and -330bps (10.7%) respectively has been prudent in managing its book through the crisis, having made substantial provisions in the past couple of quarters to help the bank absorb any potential asset quality shocks. This has resulted in strong coverage ratios of 118% (Loan Loss Reserves/NPL). We feel that cost of risk is broadly contained for BK (down

80bps to 3.7% ytd) and expect reversion to a more normalized cost of risk will happen sooner rather than later, and as mentioned by management, see potential for a release of excess provisions as the macro environment improves in the wake of the COVID-19 pandemic.

- **Costs & Digitization.** Reported Cost-Income Ratio was slightly lower than expected at c.35%, despite having increased 100bps over the prior period in line with management's guidance for a slight pick-up in OpEx tied to investments in personnel and infrastructure (+25% OpEx growth, y/y). Management guided toward CIR < 40% in coming periods, on strong income generation and controlled cost growth. Management also pointed to the increasing focus in growing digital platforms, with the upgraded core-banking platform expected to deliver strong digital capabilities that will see a revamp of the existing digital offering. BK's ambitions in the current strategy period are to have at least 20% of bank customers serviced by digital, with end-to-end automation of 14 processes targeted by FY24E. Currently, the number of *IKOFI* registered users grew +1% ytd, and currently stands at 262K (250K in Dec 2020), while *BKQuick* loans have shrunk -36% as still early days for the product. We believe that BK's scaling up of its digital infrastructure, and leveraging its brand, will lower acquisition costs and allow for significant share gains in the retail segment.

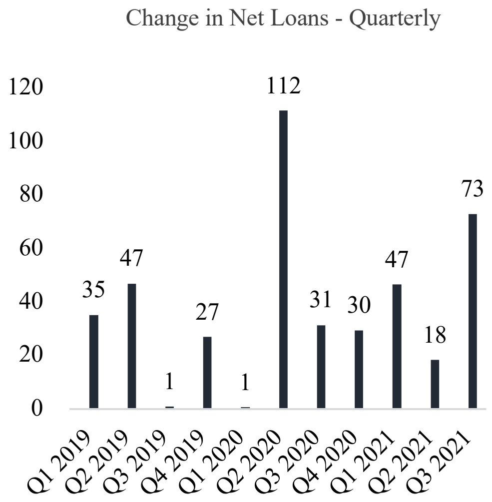
- **Profitability.** PAT for 3Q21was, up +20% y/y and 19% q/q. 9M21 profit grew +33% to Frw 37Bn which was 86% of our full year estimate. Reported RoAA/E at 9M21 stand at 3.4% and 18.2% which came in well above our forecasts for the year. As earlier mentioned, the PAT outperformance was largely driven by lower provisioning and higher non-interest income, while tempered by OpEx growth over the same period.

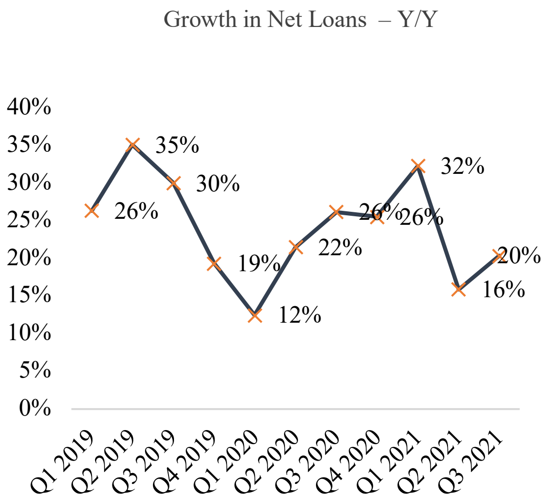
- **Dividends.** BK announced having received the go-ahead from the regulator to payout FY19 dividends in 4Q21. We view the announcement as positive and as well set our sights on the potential FY21E dividend, which at a 50% dividend payout ratio implies a forward dividend yield of c.11% at current market prices. We as well do not rule out the possibility of a special dividend in FY '21, but have not factored this into our forecasts.

- **Current valuation suggests substantial upside potential.** We are BUY rated in BK with a price target of RWF 356 (KES 38.23). We note the attractive forward dividend yield of c.11% FY '21 (12 Month Rwanda T-Bill c8.6%) which we think has further room to grow and is sustainable given the bank's solid CAR and capacity to further grow earnings.

  Key upside risks to our focus include: 1) better than expected operational performance including on Asset Quality; 2) faster capital return to shareholders and 3) general improvement in the macro situation as the economic environment marches towards normalcy. To the downside, risks include 1) more significant than expected economic fallout from COVID-19 related pressures; 2) challenging regulatory measures and 3) slippages in strategy execution in the face of rising competition from regional banks

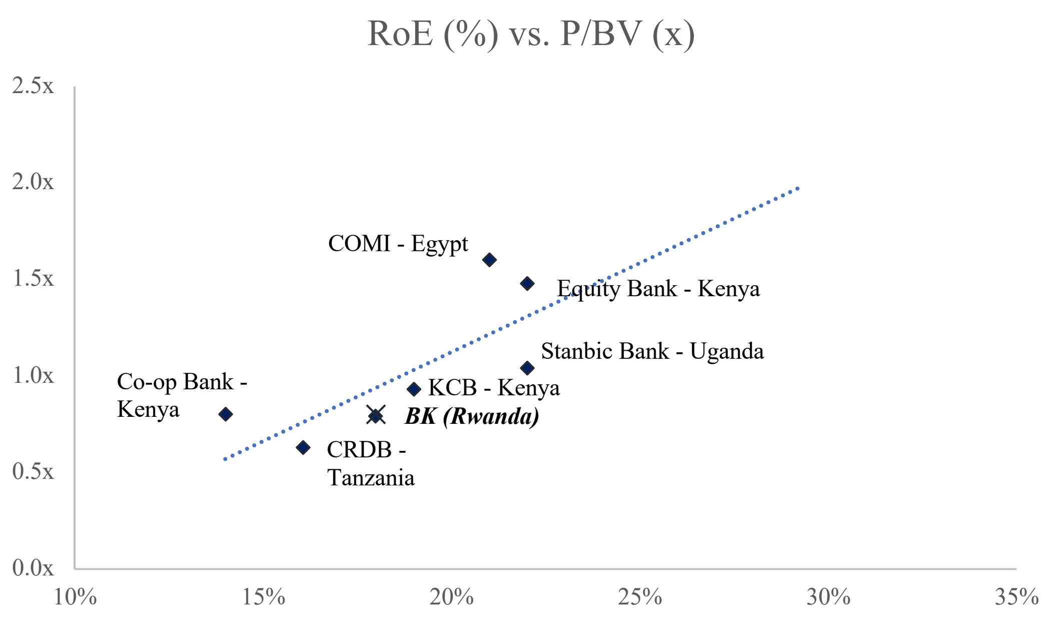
Exhibit 1: Asset Growth Trends – Solid Trailing Twelve Months on Government Related Lending





Source: Company Investor Presentation, Analyst Estimates

Exhibit 2: [FY 2021e] RoE vs. P/BV Regression



Source: Company Investor Presentation, Bloomberg, Analyst Estimates

Summary Financial Projections (1)

BK Group Profit model	FY 21E	FY 22E	FY 23E
Net Interest Income	**128**	**148**	**175**
Non-Interest Income	43	45	52
Fee Income	19	22	25
Treasury Income	12	14	16
Other Income	12	9	10
Operating Revenue	**171**	**193**	**227**
Operating Expenses	(62)	(71)	(89)
Preprovision Operating Profit	**108**	**122**	**139**
Total Provision Charge	(39)	(45)	(51)
Pretax Profit	**70**	**77**	**88**
Tax	(22)	(24)	(27)
Net Profit	48	53	61
Dividends	24	26	30

YoY growth (%)	FY 21E	FY 22E	FY 23E
Net Interest Income	**13.6%**	**15.5%**	**18.3%**
Non-Interest Income	59%	5%	16%
Fee Income	45%	18%	16%
Operating revenue	22%	13%	18%
Operating expenses	37%	15%	24%
Preprovision Operating Profit	**15%**	**12%**	**14%**
Provision Charges	5%	16%	13%
Pretax Profit	22%	10%	15%
Net Profit	**25%**	**10%**	**15%**

Dupont analysis (% of assets)	FY 21E	FY 22E	FY 23E
Net Interest Income	9.1%	9.1%	9.3%
Non-Interest Income	3.0%	2.8%	2.8%
Operating Revenue	12.1%	11.9%	12.1%
Operating Expenses	-4.4%	-4.4%	-4.7%
Preprovisioning Operating Profit	7.7%	7.5%	7.4%
Loan loss provisions	-2.8%	-2.8%	-2.7%
Taxes	-1.5%	-1.5%	-1.4%
ROA (%)	3.4%	3.3%	3.2%
x Leverage	**5.2**	**5.5**	**5.8**
= ROE (%)	**17.7%**	**17.8%**	**18.6%**

Summary Financial Projections (2)

Balance Sheet	FY 21E	FY 22E	FY 23E
Net Loans & Advances	1,000	1,190	1,346
Total assets	**1,519**	**1,731**	**2,032**
Customer Deposits	981	1,167	1,359
Current Accounts			
Savings Accounts			
Total Equity	**283**	**310**	**340**
Total Liabilities	**1,236**	**1,421**	**1,692**

YoY growth (%)	FY 21E	FY 22E	FY 23E
Loans	18%	19%	13%
Assets	16%	14%	17%
Customer deposits	24%	19%	17%
Equity	9%	9%	10%
Liabilities	18%	15%	19%

Key Ratios (%)	FY 21E	FY 22E	FY 23E
Net interest margin	**10%**	**10%**	**10%**
Non interest income/ Total income	25%	23%	23%
Cost/Income ratio	37%	37%	39%
Provision charge/total loans	**4.2%**	**4.1%**	**4.0%**
Loan/ deposit ratio	102%	102%	99%

Valuation	FY 21E	FY 22E	FY 23E
P/E x	4.7x	4.3x	3.7x
P/B x	0.8x	0.7x	0.7x
Dividend Yield (%)	10.7%	11.7%	12.1%

Per share data	FY 21E	FY 22E	FY 23E
EPS	53.30	58.71	67.26
DPS	26.65	29.35	33.63
BVPS	314.58	343.93	377.56

Source: Company Filings, Analyst Estimates

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