January 11, 2021

RECOMMENDATION

BUY

BK GROUP PLC (Rwanda)

Return Potential: +40% on RSE, +90% on NSE

Buy with RWF 326 Price Target

On 27th November, BK Group PLC ("BK") reported 9M20 results and followed this with an earnings call on 1st December to discuss operating performance and to update guidance for FY21. The call was broadly positive for share performance (indeed, the more active Nairobi cross-listed line is up c.29% to KES 19.00 after the investor call) with positive sentiment suitably informed by management's: **(1)** upbeat tone and reasonably bullish forward guidance including a commitment to drive ROE to 20% in FY21 **(2)** the continued improvement in recovery trends **(3)** comfort on asset quality having made aggressive provisions at the onset of the crisis **(4)** continued focus on digitization, with Bank of Kigali's ("BoK")'s new internet banking platform contributing meaningfully to deposit growth, the ongoing development of a new agency platform and plans of an aggressive rollout of the e-wallet and payments app IKOFI in 2021.

We believe BK offers a compelling risk-reward given it is trading at 0.6x FY22 BVPS and we note the relative underperformance of BK's share price vs. other Kenyan Tier 1 Banks/Holdcos, despite the former showing higher quality earnings and a stronger growth outlook. **We have a Buy rating on BK with a price target of RWF 321 suggesting c.43% upside on the Kigali line (RSE) and c.75% on the Nairobi line (NSE).**

Key Takeaways from 9M 20 Call

At 9M20, Net Income was RWF11.5Bn, up c.10% yoy with RoAE at 16%. Growth was resilient in the face of 2019-nCov (COVID-19) related challenges, with Net Loans up c.26% to RWF821Bn driven by growth in the corporate segment. Liabilities were strong in the period with Deposits up c.30% to RWF773Bn. Credit costs moderated at c.4.5% of Loans, increasing our confidence in management's approach to loan loss provisioning, and in the overall quality of the book, with a 10bps reduction in NPLs to c.5.5%. Elsewhere NIM decline on a yoy basis was more pronounced, down 5bps, while Non-Interest Income grew c.4.9% supported by growth in Treasury Income and increased contribution from subsidiaries, in the face of a c.16% yoy decline in Net Fee and Commission Income. BoK's capital position remains strong despite the 400bs decline in CT1 ratio (c.23.2%) which was attributed to the reclassification of a bridge loan that was previously classified as government debt. At current levels, BoK has a >820bps capital buffer above the regulatory minimum.

Earnings Update

BK GROUP PLC

Market Price:
RSE: RWF 233
NSE: KES 19

Target Price:
RSE: RWF 326
NSE: KES 36

Upside:
RSE: +40%
NSE: +90%

Sector:
Financial Services (Banks)

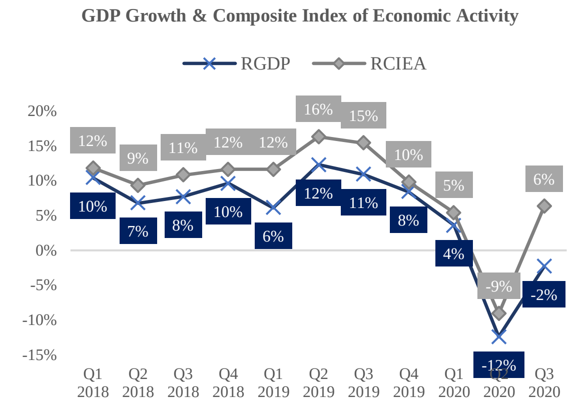
Analyst:
Team Coverage

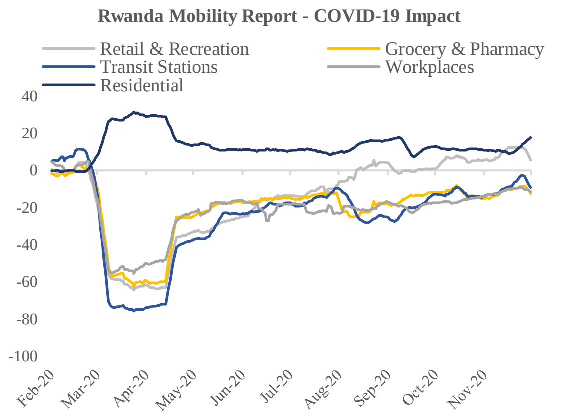
(250) 788 143 241
bkcapital@bk.rw

Industry Analysis: Macro recovery supportive of return to growth

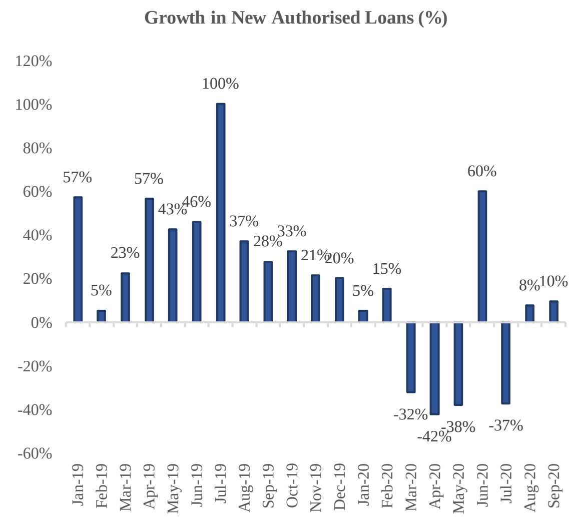
The Macro environment is showing signs of improvement
While it is still too early to call, recent data from the National Bank of Rwanda (NBR) suggests that on the macro front, the worst may very well be behind us. On a broader level, we are seeing improvement in multiple macro health trackers including a steady increase in the demand for credit. As COVID-19 related lockdowns have eased, mobility has improved from Q2 20 lows and the economy has begun its march towards normalization and a return to historical growth rates. Should the virus remain under control and restrictive measures towards trade and mobility remain low, we do expect to see a sustained improvement in industrial activity (including in the SME segment) which would in turn make the case for a sustained uptick in private sector credit growth in late FY21 and FY22. There is also optimism that a rapid and widespread distribution of a COVID-19 vaccine could lead to a gradual recovery in international travel and tourism in FY22, which would be broadly positive given the sector's c.15% contribution to Rwanda's GDP.

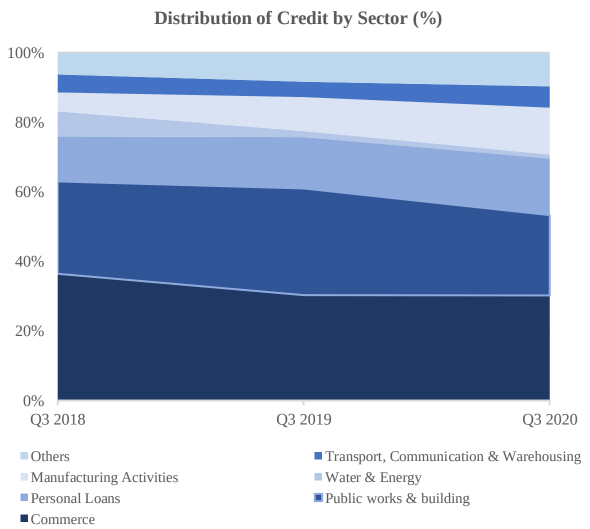
Exhibit 1: Indicators are pointing towards improving trends in consumer activity and the economy





With signs of loan revival visible in Q3 2020, driven by corporate lending



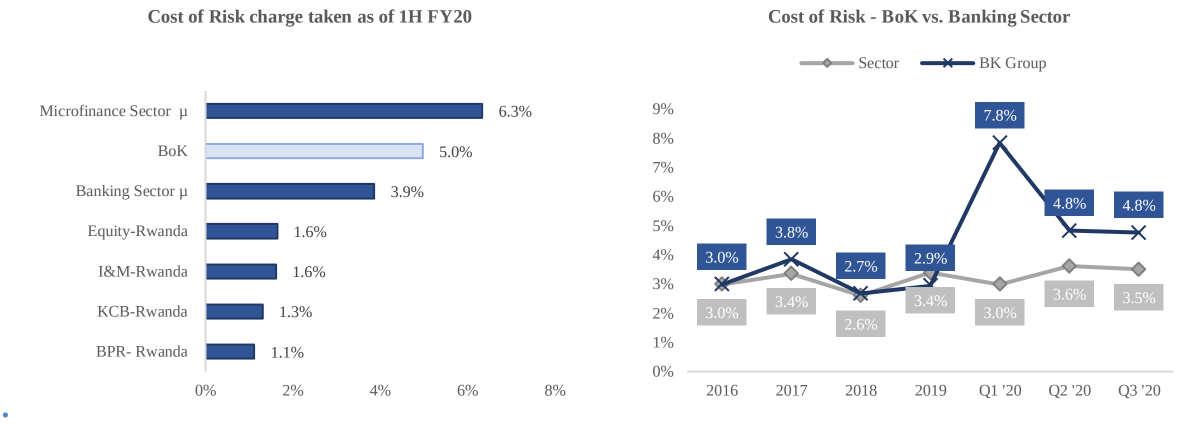


Source: NBR data, Google Mobility, Analyst Estimates

Gradual easing of credit quality concerns

Our thesis is that lenders who have been prudent enough to take provisions upfront in FY20/21 shall be better placed to navigate credit markets in coming years. As at HY 20, most banks in Rwanda had made provisions that were generally in line with historical cost of risk ratios, which was a lower level of provisioning than we expected. BoK however bucked the trend and was quite aggressive in provisioning as at the end of Q1 20 before revising cost of risk estimates lower on the back of increased confidence in asset quality and as well on account of a resumption in loan growth. Management also highlighted on the call that there had been positive interactions with a number of their clients under moratorium or where loans had been restructured. Management have guided towards a normalization in cost of risk potentially by 2H FY22 which will bode well for earnings.

Exhibit 2: Cost of Risk appears to be contained for the system, but BoK prudently leads the sector in provisioning

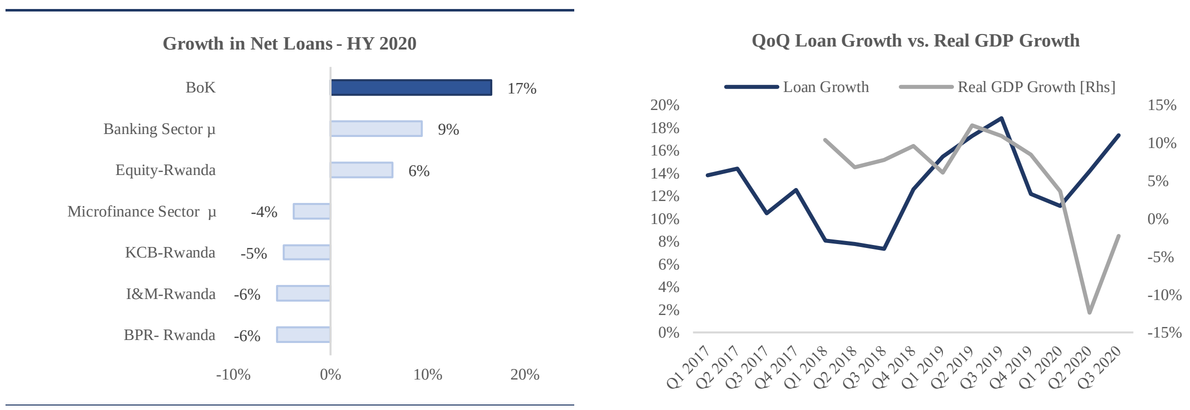


Source: NBR data, Company Filings

Can growth be sustained?

As concerns around asset quality abate, focus is likely to shift towards opportunities for growth. While most banks in Rwanda were naturally unwilling/unable to expand their books as at HY 20, we do expect to see normalization in loan growth in FY22 and beyond; as the macro recovery will be well underway. Indeed, NBR data on the distribution of new authorised loans at 9M 20 showed rising demand for personal loans and the manufacturing sector. We expect these segments will have increased appetite for credit over time, while sectors like hospitality could take longer to regain momentum. Demand for credit will also be driven by scale infrastructure projects such as the planned *Bugesera* Intl. airport.

Exhibit 3: As macro recovers and economic activity picks up; we should see loan growth recover



Source: NBR, Company Filings, Analyst Estimates

Reiterate BUY on BK Group; under-appreciated, quality franchise; faster capital return could provide the catalyst

During the 9M 2020 call, BoK's management also presented initial guidance for 2021. Below we summarise our key takeaways from this, our forecast updates and our performance expectations going into 2021.

Exhibit 4: Strategy Targets & Guidance

Management Guidance & Strategy Targets

		Management Targets [2021]	
		@ YE 2018	@ 9M 2020
Growth	Loans	20% - 25%	10% - 20%
	Deposits	20% - 25%	15% - 25%
Margins	NIM	10.5% - 11%	10.5% - 11%
Fee Income	Fee Income Growth	30% - 40%	20% - 30%
Loan Quality	CoR	1.5% - 2%	3% - 5%
	NPL	4% - 5%	≤ 8%
Efficiency	Cost/Income	40% - 45%	40% - 45%
Profitability	ROE	18% - 25%	18% - 20%

Source: Company Investor Presentation, Analyst Estimates

- **20% ROE Target over the next year**. BoK aims to deliver 20% ROE in 2021 as a slightly elevated cost of risk (3%-5%) should be balanced by continued momentum in loan growth (10%-20%) and rising fee income and a growing contribution from its non-lending businesses in Asset Management (BK Capital), Insurance (BK General Insurance) and non-financial services.

Exhibit 5: Summary of Forecast Updates

Forecast Updates

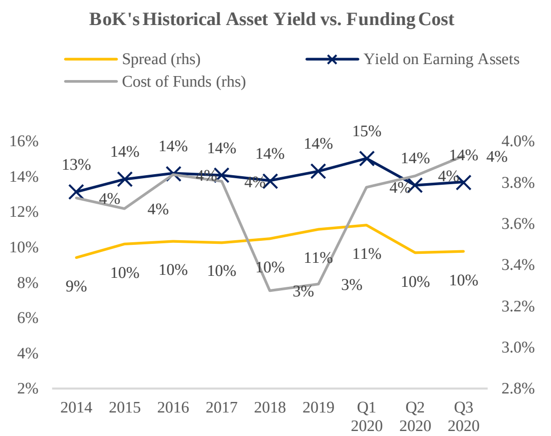
Bank of Kigali	BK Capital Estimates			YoY			Consensus Estimates		
RWF	2020E	2021E	2022E	2020E	2021E	2022E	2020E	2021E	2022E
Net Interest Income	107,925	125,080	146,297	14%	16%	17%	110,259	130,716	150,045
Fees	31,805	33,254	38,332	21%	5%	15%	27,694	31,614	36,167
Revenues	139,730	158,334	184,629	-100%	13%	17%	137,953	162,330	186,212
Expenses	(59,375)	(74,775)	(86,082)	-100%	26%	15%	(47,398)	(56,263)	(65,228)
Pre-Provisioning Profit	80,355	83,559	98,547	-100%	4%	18%	90,555	106,067	120,984
Provisions	(38,620)	(26,962)	(29,008)	-100%	-30%	8%	(36,291)	(33,626)	(32,734)
Profit Before Tax	41,734	56,596	69,539	-100%	36%	23%	54,264	72,442	88,251
Returns									
ROE	15.8%	19.5%	19.1%	-2.3pp	3.7pp	-0.4pp	16.2%	19.9%	21.3%
ROA	3.1%	3.7%	3.7%	-0.9pp	0.7pp	-0.1pp	3.3%	3.8%	4.0%
Ratios									
NIM	10.1%	10.3%	10.5%	-109bp	20bp	20bp	10.5%	10.7%	10.6%
CoR	5.1%	3.0%	2.8%	215bp	-210bp	-20bp	4.3%	3.5%	3.0%
C/I	35.5%	37.5%	40.5%	-601bp	200bp	300bp	34.4%	34.7%	35.0%
Growth									
Loan Growth	23%	15%	16%	4.0pp	-8.5pp	0.7pp	20%	14%	14%
Asset Growth	18%	15%	15%	1.8pp	-3.0pp	-0.4pp	17%	16%	15%
Deposit Growth	25%	18%	17%	3.7pp	-6.5pp	-1.0pp	25%	20%	19%

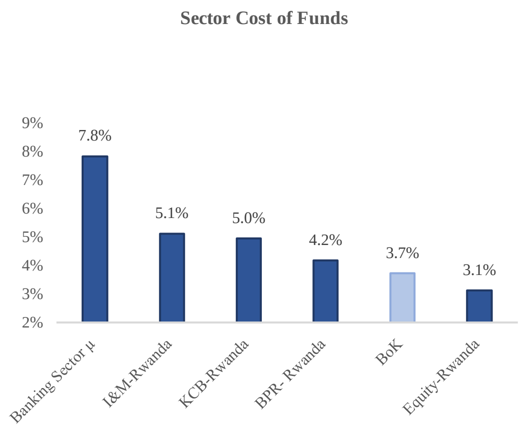
Source: Company Investor Presentation, Analyst Estimates

- **Robust loan and deposit growth outlook.** BoK expects robust demand from corporate loans to continue to be solid over the next 3 years at c.16% CAGR, with faster recover driven by corporate demand and scale infrastructure projects. Growth will of course be tempered by the banks ambition to bring its loan/deposit ratio in line with recommendations (targeting 85%-90% by FY23) so on the funding side, we do expect to see sustained growth in corporate and retail deposits. Management has also highlighted a desire to reduce its funding gap and targets to lower loan maturities to c.5.5 years to reduce mismatch on its books.

- **NIM may come down further.** At the 9M call, BoK pointed to some NIM pressure having come from declining asset yields, including from lower primary market treasury yields, and high cost of funds as some large trust accounts demanded higher interest rates. We expect the pressure on NIM to moderate despite a potentially upward sticky cost of funding on the back of competition for deposits. These pressures would be offset by stronger loan growth in FY21 and a loan mix shift towards more retail and SME loans in FY23, while the corresponding pickup in asset yields may only begin in FY23.

Exhibit 6: NIM has come under pressure on lower asset yields and higher funding costs; should stabilise here



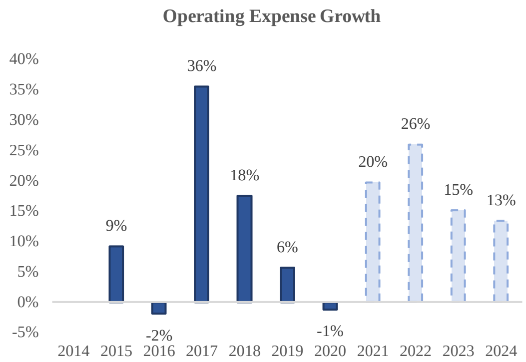


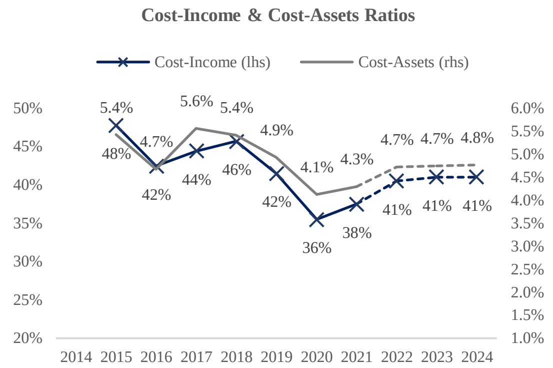
Source: NBR data, Company Filings, Analyst Estimates

- **Asset Quality.** BoK has prudently upfronted provisions in FY20, with one of the highest asset provisioning charges in the sector at nearly 5% of loans as at 9M 2020. We do expect to see Cost of Risk coming off in FY21 relative to peers but remaining slightly elevated at c.80bps-100bps above historical levels. While it will be important to monitor trends in collection efficiency and the level of restructuring requests going forward, we note that management has guided towards a potential release of some provisions driven by changes to the macro-model assumptions, as the economic outlook improves. In FY20, this will be counterbalanced by the going live of a new ERP system which may result in some one-off adjustments in Q4 20 and some of the benefit trickling into FY21. Coverage levels remain high at c.120% of NPLs as at 9M 2020.

- **Costs & Digitalization.** Underlying cost growth in FY20 was negative, in part driven by lower travel and consulting expenses. Overall, the cost to income ratio declined to c.36% which level is likely unsustainable and we expect to see this increase in FY21. Looking ahead, BoK stands to benefit from the digitization trends intensified by COVID-19 in driving cost efficiency. Growth of the branch and agency network remains a priority and as well pushing for growth of IKOFI which will allow banking services over the phone. As at 9M September, had 253K registered users and 1.8K registered agents. IKOFI will provide additional upside in the long run as usage of digital platforms increases.

Exhibit 7: We expect an increase in cost-income ratio, but an improvement in cost efficiency overall

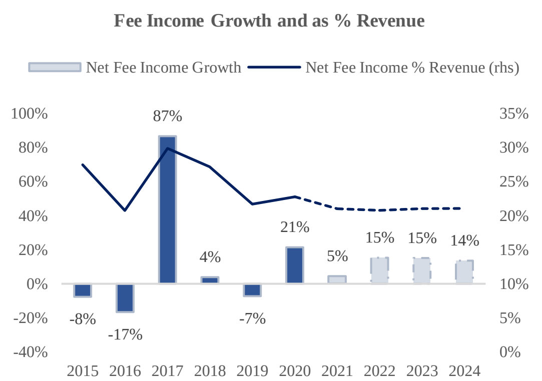


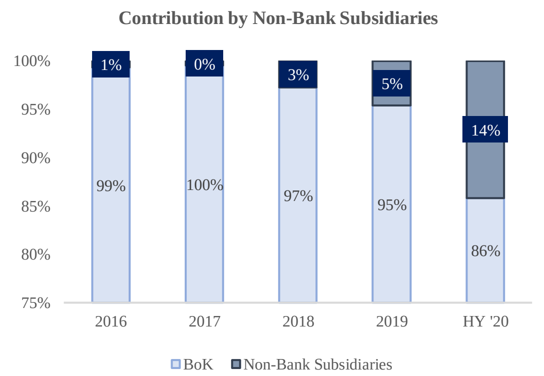


Source: Company Filings, Analyst Estimates

- **Focus on Fee income & Non-banking income.** Fee income is expected to grow at double digits through FY23. The growth is expected to come from the expected recovery in economic activity that would potentially boost transactional income, specifically in trade finance & FX conversion. Management also alluded to an upward review of certain tariffs which should further boost certain income as volumes come back. BK also targets to grow the contribution from its non-banking segment, and has seen good progress from these lines of business (+93% yoy income growth as at HY 20) given their nascency and the relatively low penetration Asset Management & Advisory has performed strongly (RWF 238MM) as has the General Insurance business (RWF 119MM) which has been seeing strong double-digit growth with a c.37% CAGR on net premium income over the last 3 years. We were also encouraged to learn that BKTechouse was already starting to monetize its data trove (RWF 259MM) and do expect to see an increasing contribution from digital banking revenue, given BoK's market leading position in merchant acquiring and through its payment gateway system.

Exhibit 8: Fee Income will continue to grow as a share of revenues, with a larger contribution by subsidiaries

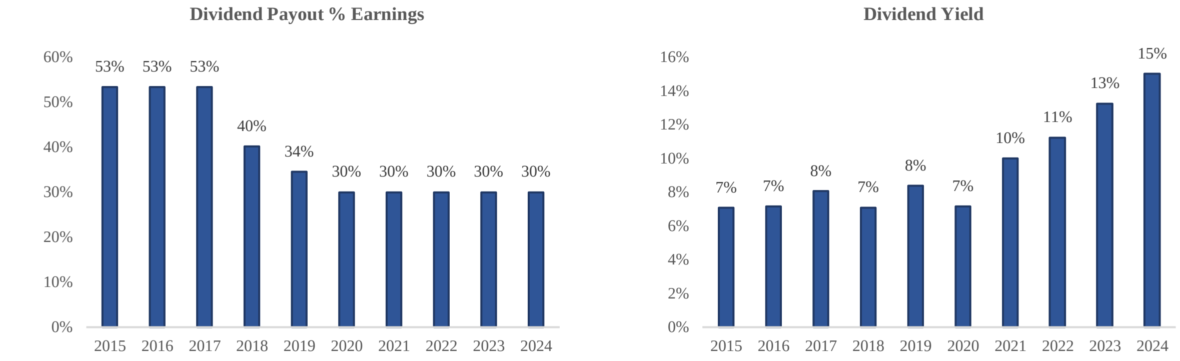




Source: Company Filings, Analyst Estimates

- **Dividend policy maintained and share buybacks on the table; capital return could be swing factor** We expect management will look to distribute any "excess capital" dilutive to ROE to shareholders through dividends. Share buybacks have also been considered (and represent an important catalyst) but appear to have been shelved for now given the low liquidity on the NSE line following sustained selling pressure in 2020. BoK maintains a solid capital position across its businesses which allows for a high dividend payout (unless capital allocation priorities were to change given the recent M&A activity in the region/sector e.g.. *KCB Group's* acquisition of *bpr AtlasMara*, we however see the probability of this as being low for now). With recovery in ROE, and our profitability forecasts, we think that BK has sufficient room to increase its distributions over time. We have however not factored this assumption into our forecasts. The group's position on the declaration of a final dividend for FY20 and as well the payout of the FY19 dividend will depend on approvals from the NBR.

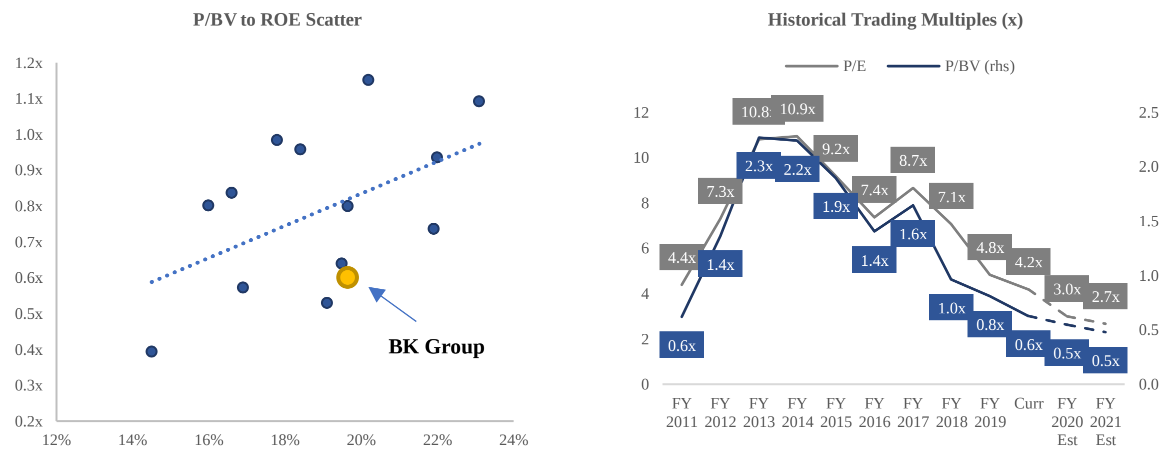
Exhibit 9: Strong Capital position allows for higher dividend payout



Source: Company Filings, Analyst Estimates

- **Current valuation suggests substantial upside potential.** The stock is trading at 3.0x and 0.6x 12M fwd P/E and P/BV respectively (NSE price), which are the lowest levels in the bank's trading history and which looks very compelling given the superior earnings profile and dividend upside.

Exhibit 10: Selected publicly traded Banks by P/BV (x) vs. ROE %



Source: Bloomberg, Analyst Estimates

Summary Financial Projections (1)

BK Group Profit model	FY 20E	FY 21E	FY 22E	FY 23E
Net Interest Income	**107,925**	**125,080**	**146,297**	**165,831**
Non-Interest Income	31,805	33,254	38,332	44,125
Fee Income	14,388	17,076	19,684	22,659
Treasury Income	9,844	11,684	13,468	15,503
Other Income	7,573	4,494	5,180	5,963
Operating Revenue	**139,730**	**158,334**	**184,629**	**209,956**
Operating Expenses	(49,604)	(59,375)	(74,775)	(86,082)
Preprovision Operating Profit	**90,126**	**98,959**	**109,854**	**123,874**
Total Provision Charge	(38,620)	(26,962)	(29,008)	(28,622)
Pretax Profit	**51,505**	**71,996**	**80,846**	**95,252**
Tax	(14,539)	(20,323)	(22,821)	(26,888)
Net Profit	36,967	51,673	58,025	68,365

YoY growth (%)	FY 20E	FY 21E	FY 22E	FY 23E
Net Interest Income	**13.9%**	**15.9%**	**17.0%**	**13.4%**
Non-Interest Income	21%	5%	15%	15%
Fee Income	-1%	19%	15%	15%
Operating revenue	16%	13%	17%	14%
Operating expenses	-1%	20%	26%	15%
Preprovision Operating Profit	**27%**	**10%**	**11%**	**13%**
Provision Charges	110%	-30%	8%	-1%
Pretax Profit	-2%	40%	12%	18%
Net Profit	**-2%**	**40%**	**12%**	**18%**

Dupont analysis (% of assets)	FY 20E	FY 21E	FY 22E	FY 23E
Net Interest Income	9.7%	9.7%	9.9%	9.8%
Non-Interest Income	2.9%	2.6%	2.6%	2.6%
Operating Revenue	12.6%	12.3%	12.4%	12.4%
Operating Expenses	-4.5%	-4.6%	-5.0%	-5.1%
Preprovisioning Operating Profit	8.1%	7.7%	7.4%	7.3%
Loan loss provisions	-3.5%	-2.1%	-2.0%	-1.7%
Taxes	-1.3%	-1.6%	-1.5%	-1.6%
ROA (%)	3.3%	4.0%	3.9%	4.0%
x Leverage	**4.8**	**4.9**	**4.9**	**4.9**
= ROE (%)	**15.8%**	**19.5%**	**19.1%**	**19.7%**

Summary Financial Projections (2)

Balance Sheet	FY 20E	FY 21E	FY 22E	FY 23E
Net Loans & Advances	836,517	960,978	1,111,037	1,274,107
Total assets	**1,202,413**	**1,382,614**	**1,583,743**	**1,813,874**
Customer Deposits	800,160	944,189	1,104,701	1,286,977
Current Accounts				
Savings Accounts				
Total Equity	**246,688**	**282,859**	**323,476**	**371,332**
Total Liabilities	**955,726**	**1,099,755**	**1,260,267**	**1,442,542**

YoY growth (%)	FY 20E	FY 21E	FY 22E	FY 23E
Loans	23%	15%	16%	15%
Assets	18%	15%	15%	15%
Customer deposits	25%	18%	17%	17%
Equity	12%	15%	14%	15%
Liabilities	20%	15%	15%	14%

Key Ratios (%)	FY 20E	FY 21E	FY 22E	FY 23E
Net interest margin	**10%**	**10%**	**11%**	**10%**
Non interest income/ Total income	23%	21%	21%	21%
Cost/Income ratio	36%	38%	41%	41%
Provision charge/total loans	**5.1%**	**3.0%**	**2.8%**	**2.4%**
Loan/ deposit ratio	105%	102%	101%	99%

Valuation	FY 20E	FY 21E	FY 22E	FY 23E
P/E x	4.3x	3.1x	2.7x	2.3x
P/B x	0.6x	0.6x	0.5x	0.4x

Per share data	FY 20E	FY 21E	FY 22E	FY 23E
EPS	41.05	57.38	64.43	75.91
DPS	12.31	17.21	19.33	22.77
BVPS	273.93	314.09	359.19	412.33

Source: Company Filings, Analyst Estimates

Important Disclosures

Relationship: BK Capital is a wholly owned subsidiary of BK Group PLC.

Liquidity Provider: BK Capital and/or an affiliate may act as a broker or liquidity provider in securities issued by BK Group PLC.

Client: BK Capital currently has, or had within the past 12 months, BK Group PLC as a client.

Corporate Finance BK Capital received in the past 12 months or expects to receive or intends to seek compensation for corporate finance services from BK Group PLC

Explanation of Equity Research Ratings and Designations:
BK Capital uses the following rating system: Buy, Neutral, Sell, Not Rated. Being assigned a Buy or Sell is determined by a stock's return potential. Any security not assigned a Buy or Sell rating is considered Neutral. A Not Rated designation may apply when a stock is currently not under BK Capital's coverage or scope.

This research is for our clients only. Other than disclosures relating to BK Capital, this research is based on current public information that we consider reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. The information, opinions, estimates and forecasts contained herein are as of the date hereof and are subject to change without prior notification. We seek to update our research as appropriate, but various regulations may prevent us from doing so. Other than certain industry reports published on a periodic basis, the large majority of reports are published at irregular intervals as appropriate in the research team's judgment.

This research is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Clients should consider whether any advice or recommendation in this research is suitable for their particular circumstances and, if appropriate, seek professional advice, including tax advice. The price and value of investments referred to in this research and the income from them may fluctuate. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Fluctuations in exchange rates could have adverse effects on the value or price of, or income derived from, certain investments.