June, 21 2021

RECOMMENDATION

BUY

BK GROUP PLC (Rwanda)

Return Potential: +51% on RSE, +43% on NSE

Takeaways from the Q1 2021 Call & FY 2020 AGM; robust lending trends, AGM announcements welcome; reiterate Buy

On 2nd June 2021 and 16th June 2021, we joined BK Group PLC ("BK") on their post Q1 21 results call and their AGM for the FY ended 2021 respectively.

Our key takeaways from both calls are summarised as below:

- **Volume growth**. Management noted that Net Loan growth in Q1 '21 had come in better than expected, (c.32 Y/Y and c.5% Q/Q) driven by demand from large corporates and some good tickets linked to government expenditure. Risk appetite for SME and Retail sectors remains understandably low, given the disrupted state of the economy in these uncertain times. The bulk of the loan book is skewed towards mortgages and (commercial) real estate, followed by consumer loans tied to salaried customers. Despite the uptick, management remains prudent in their guidance and expects loan growth to normalize at c.10% -15% Y/Y for FY '21.

  Customer Deposits performed strongly in Q1 '21 (c.23% Y/Y and c.7% Q/Q), with funds deployed into new loans and treasuries to support NIMs in the period.

- **Asset Quality**. We highlight a pick-up in NPL's during the period (c.8.0% vs. c.6.7% in Q4 '20) despite the strong loan growth seen in the quarter. In addition, NPL coverage dropped to c.97% from a high of c.121% in Q1 '20. Management alluded to an NPL affecting a sizeable commercial real-estate loan as the reason for the increase, but expressed optimism in their ability to restructure it, and as well taking confidence in the quality of the collateral backing the loan.

  As seen elsewhere, Hospitality and Transportation sectors have been hardest hit by the lockdown, with some knock-on effects in commercial real estate. There are however some positive signs pointing towards potential for faster than anticipated recovery in these sectors, especially following the hosting of the *Basketball Africa League* in May 2021 (which gives hope for a rebound in tourism/conferences further down the line), and the capacity increase in public bus transport services (now mandated to 50% capacity). Cost of Risk at c.4.7% was only slightly above our estimate (4.5%) and management reiterated their commitment to bring that lower in line with their guidance of c.3.5% for the year. NPL Coverage ratio is also expected to go above 100% in coming quarters due to better management of NPL. We believe Asset Quality remains manageable despite the blip seen this quarter.

- **Costs & Digitization.** Cost-Income Ratio was lower than expected at c.29.2%. Management noted that some of the savings seen over the last 12 months (e.g., from reduced advertising & promotion and from a relatively static staff count with delays in recruitment) shall not be permanent and we should expect a pick-up in costs as the macro situation normalizes. In addition to higher travel and staff costs (including from bonus provisioning and new hires), there shall also be an increase in depreciation charge once the new core banking system is fully implemented in Q3 '21. Management also touched on the deal with *Sheer Logic Management* that aims to see some contract customer service jobs outsourced, with a trial expected to start with less than 20% of targeted jobs, migrating at the same terms. The decision to outsource is in part informed by the continued shift to digital/alternative channels by the bank's customers, and management believes that this decision will yield efficiency gains in the medium to long term, as the digital transformation continues.

  Further on digitization, management discussed the *BK Quick* (mobile loans and savings) product, noting that whereas there was strong market demand for the service given its convenience and ease of operation, there had been a deliberate decision to not expand given current market conditions. Expectations are however that an improving macro environment, and the planned roll out of the bank's T24 core banking system will be key catalysts to supporting volume growth, which is key to managing product NPL's.

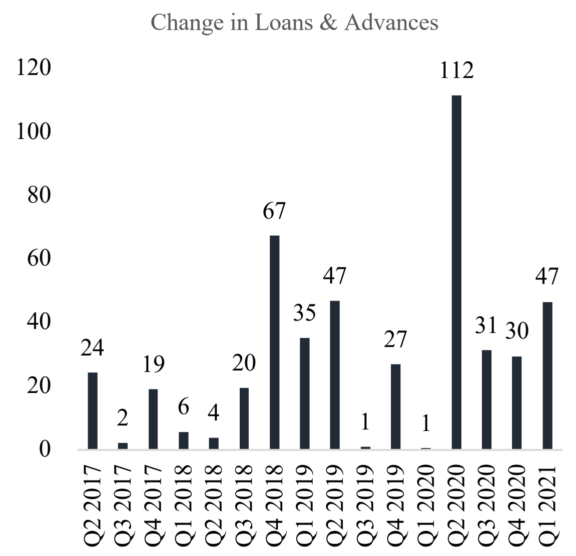
- **Profitability.** PAT for Q1 '21 was in line with our forecasts for the year. We expect short term pressure on RoE (Q1 '21 – 17%) between 2021-23 before starting to recover meaningfully over 2023/24 driven by 1) a combination of corporate credit growth (and a pick-up in the bank's strategy to expand its reach into SME and retail lending); 2) normalization of the Cost of Risk; and 3) an improvement in leverage as regular dividend payout resumes and loans and deposit volumes grow.

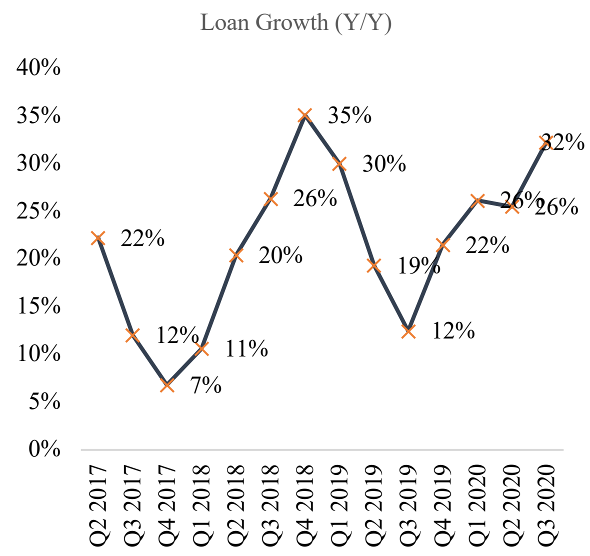
- **Dividends.** BK obtained AGM approval to increase its dividend payout ratio to c.50% of earnings (FY '18 DPR was c.43%; FY '19 DPR was c.36%) in what allows a faster return of capital to shareholders. Management also expressed confidence in the possibility of the regulators potentially permitting payout/disbursement of FY '19 dividends 'later in the year, as the situation improves'. We view both announcements as positive, given the bank's healthy CAR and strong earnings profile. While the probability of a payout from FY '20 earnings has significantly diminished, 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.10% 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.

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





Source: Company Investor Presentation, Analyst Estimates

Exhibit 2: P/B Trading Comparison for Select East African Banks (2015-2021)

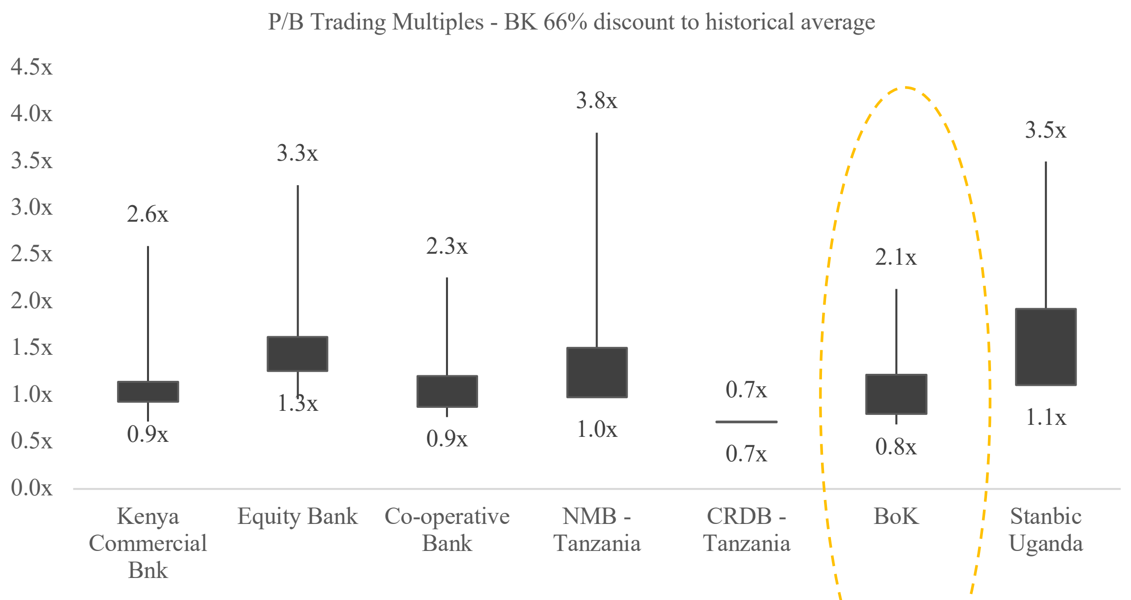
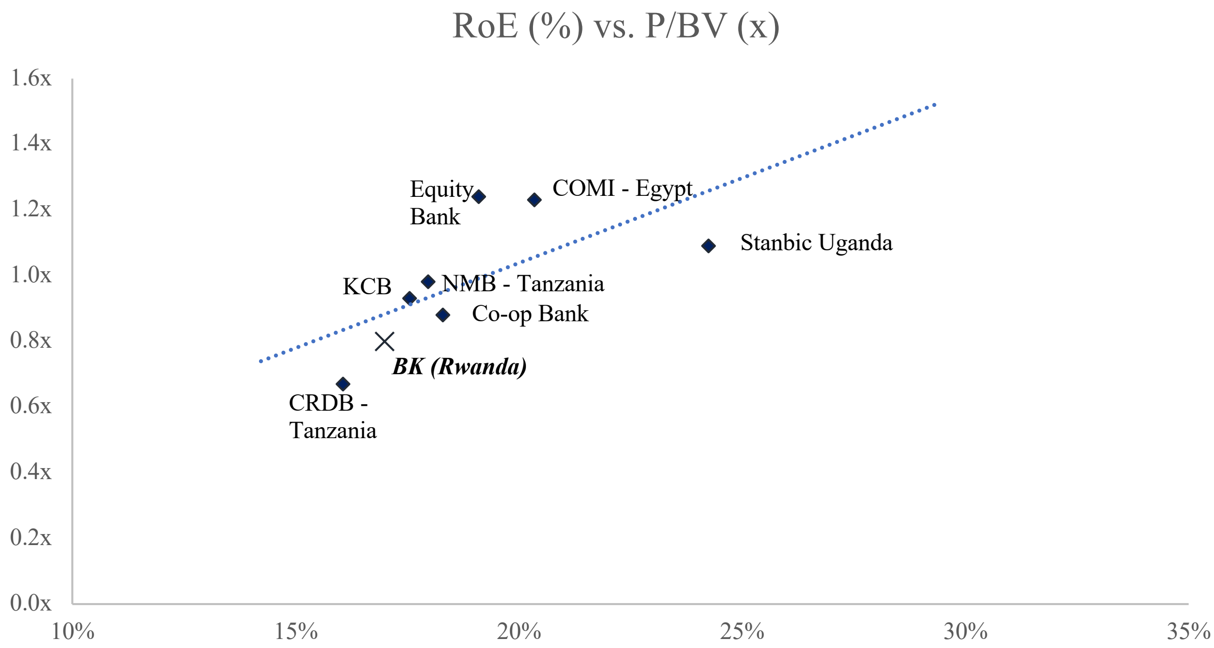


Chart shows High, Low and Current P/B multiple ranges for various regional banks

Source: Company Investor Presentation, Bloomberg, Analyst Estimates

Exhibit 3: [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	**126**	**145**	**168**
Non-Interest Income	32	34	38
Fee Income	17	18	21
Treasury Income	10	11	13
Other Income	5	4	4
Operating Revenue	**157**	**179**	**205**
Operating Expenses	(57)	(69)	(84)
Preprovision Operating Profit	**100**	**110**	**121**
Total Provision Charge	(41)	(42)	(45)
Pretax Profit	**59**	**68**	**76**
Tax	(17)	(19)	(22)
Net Profit	43	49	55
Dividends	21	24	27

YoY growth (%)	FY 21E	FY 22E	FY 23E
Net Interest Income	**11.5%**	**15.0%**	**15.9%**
Non-Interest Income	18%	7%	12%
Fee Income	34%	8%	15%
Operating revenue	13%	13%	15%
Operating expenses	26%	20%	23%
Preprovision Operating Profit	**6%**	**10%**	**10%**
Provision Charges	9%	4%	7%
Pretax Profit	4%	14%	13%
Net Profit	**11%**	**14%**	**13%**

Dupont analysis (% of assets)	FY 21E	FY 22E	FY 23E
Net Interest Income	9.0%	9.1%	9.4%
Non-Interest Income	2.3%	2.1%	2.1%
Operating Revenue	11.3%	11.3%	11.5%
Operating Expenses	-4.1%	-4.3%	-4.7%
Preprovisioning Operating Profit	7.2%	6.9%	6.8%
Loan loss provisions	-2.9%	-2.7%	-2.5%
Taxes	-1.2%	-1.2%	-1.2%
ROA (%)	3.1%	3.1%	3.1%
x Leverage	**5.2**	**5.4**	**5.6**
= ROE (%)	**15.8%**	**16.6%**	**17.2%**

Summary Financial Projections (2)

Balance Sheet	FY 21E	FY 22E	FY 23E
Net Loans & Advances	950	1,098	1,259
Total assets	**1,484**	**1,681**	**1,906**
Customer Deposits	933	1,092	1,272
Current Accounts			
Savings Accounts			
Total Equity	**281**	**305**	**332**
Total Liabilities	**1,203**	**1,376**	**1,573**

YoY growth (%)	FY 21E	FY 22E	FY 23E
Loans	12%	16%	15%
Assets	14%	13%	13%
Customer deposits	18%	17%	17%
Equity	8%	9%	9%
Liabilities	15%	14%	14%

Key Ratios (%)	FY 21E	FY 22E	FY 23E
Net interest margin	**10%**	**10%**	**10%**
Non interest income/ Total income	20%	19%	18%
Cost/Income ratio	37%	39%	41%
Provision charge/total loans	**4.5%**	**4.1%**	**3.8%**
Loan/ deposit ratio	102%	101%	99%

Valuation	FY 21E	FY 22E	FY 23E
P/E x	5.0x	4.3x	3.9x
P/B x	0.8x	0.7x	0.6x
Dividend Yield (%)	10.1%	11.5%	11.7%

Per share data	FY 21E	FY 22E	FY 23E
EPS	47.33	54.04	60.90
DPS	23.66	27.02	30.45
BVPS	311.59	338.61	369.06

Source: Company Filings, Analyst Estimates

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