GCR RATINGS

Credit Rating Announcement

GCR affirms Bank of Kigali PLC's and BK Group Plc's national scale issuer ratings of of AA+(RW)/AA(RW respectively; Outlooks stable.

Rating Action

Johannesburg, 31 August 2022 - GCR Ratings ("GCR") has affirmed the long and short-term national scale issuer ratings on Bank of Kigali Plc ('Bank of Kigali', 'the bank') of AA+(RW) and A1+(RW) respectively, with outlook accorded as Stable. At the same time, GCR has affirmed BK Group Plc's ('BK Group', 'the group') national scale long and short-term issuer ratings of AA(RW) and A1+(RW) respectively, with a Stable Outlook.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
Bank of Kigali Plc	Long Term Issuer	National	AA+(RW)	Stable Outlook
	Short Term Issuer	National	A1+(RW)	
BK Group Plc	Long Term Issuer	National	AA(RW)	Stable Outlook
	Short Term Issuer	National	A1+(RW)	

Rating Rationale

Bank of Kigali is the largest subsidiary of BK Group, a holding company with three other subsidiaries, namely BK General Insurance, BK TecHouse and BK Capital Ltd. The smaller subsidiaries are growing revenue contributions and represented 4.9% of the net profit before tax ('NPBT') to the group in FY21. We opine that Bank of Kigali will continue to be the most significant subsidiary of the group for the foreseeable future and will therefore continue to drive the rating accorded to the group.

The rating on the bank reflects its earnings improvement, lending comfort to capitalization with stable risk, funding and liquidity profiles.

The ratings accorded to BK Group PLC factors in a strong earnings position, with a demonstrated track record over the 5-year period, coupled with a strong market share within the Rwandan operating environment. The rating also reflects a relatively stable risk position owing to a slight improvement in the NPL ratio, buttressed by high coverage levels and a robust liquidity position relative to the industry. This is however counterbalanced by funding and credit risk concentrations, with a reliance on the corporate customer base. The stable outlook reflects our overall view on revenue growth, sustained capitalization matrices with a recognition of minor improvements in the macroeconomic climate with pockets of recovery post covid-19.

BK Group PLC is the leading financial institution in the Rwandan market, ranked 1st overall relative to its peers, with a 38.6% market share by total assets and 36.4% by deposits. Supporting the bank's market position is the ongoing digitization strategy that provides a platform for deposit mobilization at a relatively low cost compared to peers, with a cost of funds ranging between 2.0% and 2.5% over the medium term. This comes on the back of a increased corporate and retail client bases by 9.7% and 10% respectively as of 31st March 2022. Additionally, we expect the group's franchise strength is to continue buttressing the overall market position over the next 12 to 18 months. This notwithstanding, we note that the groups revenues continue to be dominated by the corporate banking segment, which takes the lion's share of total revenues at 76.3%, with potential concentration risks along the key business lines. Additionally, we take note of the limited geographic diversification relative to peers, somewhat fairly to the rating.

The management and governance assessment are a neutral consideration as the governance structures are appropriate for the size of the bank. The group is publicly listed on the Rwandan and Kenyan securities exchanges with a diverse shareholding structure. The group's board composition is evenly split between independent and non-independent directors. Related party loans and exposures do exists however remain immaterial to the rating.

Capitalisation is an intermediate ratings factor. The GCR capital adequacy ratio ('GCR CAR') stands at 23.5% as at end of Q1 2022, with a regulatory Tier 1 capital adequacy ratio of 20.98% at December 2021 against a minimum regulatory requirement of 12.5%. The metric is largely in line with the industry average of 21.5% and is considered to be within the upper band of the intermediate range overall capital ratio relative to the operating environment. Additionally, the loan loss reserve coverage ratio stood at 120.8% as at FY21 (FY20: 105.2%), which is strong, in line with industry average of 119.8% and is complemented by collateralization of the loan book. The robust coverage of Stage 3 non-performing loans provides an adequate buffer to absorb expected loan losses thereby cushioning overall capitalization. Earnings were a positive ratings factor, on account of increasing profitability over the 5-year period under review, with a CARG of 17.6% on pre-provision operating income. Additionally, core earnings remain strong, with net interest income contributing a healthy 78.33% of total operating revenues and post provision operating income forming 44.19% of total operating revenues. We take note of the consistent track record in revenues, with an average Return on Average Assets ('ROaE') of 18%, above the industry average of 15%, and a 15.5% 5-year CARG on net interest income.

The risk position is a slightly negative ratings factor albeit within the lower band of the intermediate assessment range. The reported non-performing loans ('NPL') ratio remained relatively stable at 5.1% in Q2 2022 (FY21: 5.3%) however remains slightly higher than the industry average of 4.6%. The risk position is however supported by strong loan loss provisioning, bolstered further by adequate collateralization of the loan book. Accordingly, the Stage 3 loan loss reserve ratio stood at 120.8% in 2021 (2020: 105.2%) and the cost of risk reduced marginally to 3.4% in 2021 (2020: 4.2%) on account of stage-3 loan reclassifications. This notwithstanding, we note that the gross loan book, remains somewhat concentrated, with the top 20 borrowers accounting for 58% of the overall loan portfolio.

Funding and liquidity is a positive factor, balancing between a robust liquidity position derived from customer deposits (forming 95% of the funding base) and fairly inexpensive funding at 2.4% against an industry average of 3.2%. This notwithstanding, we note that the funding base is relatively skewed towards commercial sources, with large corporates and SMEs contributing 56.9% of total deposits, with financial intermediaries and retail customers contributing 16.3% and 22.7% respectively. Concordantly, this falls within the higher range of our assessment for funding and liquidity, buttressed by limited exposure to foreign currency and short-term funding risks.

The long-term national scale rating of $AA_{(RW)}$ accorded to BK Group (the non-operating holding company – 'NOHC') is one notch below the bank's rating of $AA+_{(RW)}$ to reflect the NOHC's structural subordination.

Outlook statement

The stable outlook reflects the entity's track record in earnings, in the period under review, a strong loan loss coverage position and robust liquidity matrices in light of post covid-19 recovery over the outlook horizon. Additionally, as the company actualizes its digitization strategy, we expect a diversification of the customer base with growth in retail clientele.

Rating triggers

An upgrade to the rating could be supported by increased revenue contribution from the non-bank subsidiaries and diversification in the bank's customer base which should translate to lower loan and deposit concentrations over the medium term. Additionally, a reduction in the cost of risk to levels around 2.5% will warrant an upgrade to the rating. A downgrade to the rating could be triggered by a decline in the GCR capital adequacy ratio below 20% and a reduction asset quality, above industry average predicated by pockets of stress from key obligors.

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Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
Criteria for Rating Financial Institutions, May 2019
GCR Rating Scales, Symbols & Definitions, May 2022
GCR Country Risk Scores, August 2022
GCR Financial Institutions Sector Risk Score, June 2022

Ratings History

Bank of Kigali PLC					
Rating class	Review	Rating scale	Rating	Outlook	Date
Long Term Issuer	Initial / Last	National	AA+(RW)	Stable	August 2022
Short Term Issuer	Initial / Last	National	A1+(RW)	N/A	August 2022
BK Group PLC					
Rating class	Review	Rating scale	Rating	Outlook	Date
Long Term Issuer	Initial / Last	National	AA(RW)	Stable	August 2022
Short Term Issuer	Initial / Last	National	A1+(RW)	N/A	August 2022

Risk Score Summary

Rating Components & Factors	Risk scores
Operating environment	**7.25**
Country risk score	3.50
Sector risk score	3.75
Business profile	**1.50**
Competitive position	1.50
Management and governance	0.00
Financial profile	**1.50**
Capital and Leverage	1.50
Risk	(1.00)
Funding and Liquidity	1.00
Comparative profile	**0.00**
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total Score	**10.25**

Glossary

Accounting	A process of recording, summarising, and allocating all items of income and expense of the company and analysing, verifying and reporting the results.
Asset Quality	Refers primarily to the credit quality of a bank's earning assets, the bulk of which comprises its loan portfolio, but will also include its investment portfolio as well as off balance sheet items. Quality in this context means the degree to which the loans that the bank has extended are performing (ie, being paid back in accordance with their terms) and the likelihood that they will continue to perform.
Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
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Borrower	The party indebted or the person making repayments for its borrowings.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its risks.
Capital	The sum of money that is invested to generate proceeds.
Capitalisation	The provision of capital for a company, or the conversion of income or assets into capital.
Collateral	Asset provided to a creditor as security for a loan or performance.
Concentrations	A high degree of positive correlation between factors or excessive exposure to a single factor that share similar demographics or financial instrument or specific sector or specific industry or specific markets.
Coverage	The scope of the protection provided under a contract of insurance.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
Credit	A contractual agreement in which a borrower receives something of value now, and agrees to repay the lender at some date in the future, generally with interest. The term also refers to the borrowing capacity of an individual or company
Customer Deposit	Cash received in exchange for a service, including safekeeping, savings, investment, etc. Customer deposits are a liability in a bank's books.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Downgrade	The rating has been lowered on its specific scale.
Environment	The surroundings or conditions in which an entity operates (Economic, Financial, Natural).
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an individual or company's vulnerability to various risks
Financial Institution	An entity that focuses on dealing with financial transactions, such as investments, loans and deposits.
Income	Money received, especially on a regular basis, for work or through investments.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Issuer Ratings	See GCR Rating Scales, Symbols and Definitions.
Issuer	The party indebted or the person making repayments for its borrowings.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Loan	A sum of money borrowed by a debtor that is expected to be paid back with interest to the creditor. A debt instrument where immovable property is the collateral for the loan. A mortgage gives the lender a right to take possession of the property if the borrower fails to repay the loan. Registration is a prerequisite for the existence of any mortgage loan. A mortgage can be registered over either a corporeal or incorporeal property, even if it does not belong to the mortgagee. Also called a Mortgage bond.
Loss	1. A tangible or intangible, financial or non-financial loss of economic value. 2. The happening of the event for which insurance pays (insurance).
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
Obligor	The party indebted or the person making repayments for its borrowings.
Performing Loan	A loan is said to be performing if the borrower is paying the interest on it on a timely basis.
Performing	An obligation that performs according to its contractual obligations.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Recovery	The action or process of regaining possession or control of something lost. To recoup losses.

Reserve	(1) An amount representing actual or potential liabilities kept by an insurer to cover debts to policyholders. (2) An amount allocated for a special purpose. Note that a reserve is usually a liability and not an extra fund. On occasion a reserve may be an asset, such as a reserve for taxes not yet due.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Securities	Various instruments used in the capital market to raise funds.
Short Term	Current; ordinarily less than one year.
Tier 1 Capital	Primary capital consists of issued ordinary share capital, hybrid debt capital, perpetual preference share capital, retained earnings and reserves. This amount is then reduced by the portion of capital that is allocated to trading activities and other regulatory deductions.
Upgrade	The rating has been raised on its specific scale.
Accounting	A process of recording, summarising, and allocating all items of income and expense of the company and analysing, verifying and reporting the results.
Asset Quality	Refers primarily to the credit quality of a bank's earning assets, the bulk of which comprises its loan portfolio, but will also include its investment portfolio as well as off balance sheet items. Quality in this context means the degree to which the loans that the bank has extended are performing (ie, being paid back in accordance with their terms) and the likelihood that they will continue to perform.
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Borrower	The party indebted or the person making repayments for its borrowings.

For a detailed glossary of terms utilized in this announcement please click here

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the ratings was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to the rated entity.

The ratings of the following entities were solicited by, or on behalf of, the rated entities, and therefore, GCR has been compensated for the provision of the ratings.

BK Group PLC participated in the rating process via teleconference management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from the entities and other reliable third parties to accord the credit ratings included:

The audited financial results for 31 December 2021
The audited financial results for 31 December 2020
The audited financial results for 31 December 2019
The audited financial results for 31 December 2018
The audited financial results for 31 December 2017
Quarterly investor presentation for 31 March 2022
Other related information

In our opinion, the national scale credit ratings on Rwandan entities are not directly comparable to credit ratings and risk scores within other markets due to implied volatility in the ratings. Due to hyperinflation, high risk of monetary and exchange control policy changes, and significant accounting judgement, creating high likelihood of frequent change on the financial profiles of entities operation therein. Furthermore, outlook statements may fail to capture forward looking trends due to the high volatility in the operating environment. See the latest Jurisdictional Supplement for Criteria, published, available at https://gcrratings.com/criteria/