

Bank of Kigali Plc

Rated Entity	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)}	

Rated Entity	Rating class	Rating scale	Rating	Outlook / Watch
BK Group Plc	Long Term Issuer	National	AA ^(RW)	Stable Outlook
	Short Term Issuer	National	A1 ^{+(RW)}	

Strengths

- Strong market position with relatively good business diversification.
- Strong capitalization to support growth.
- Sound funding structure and good levels of liquidity.

Weaknesses

- Relatively weak risk position due to higher non-performing loans.
- Limited regional diversification outside the Rwanda market.

Rating rationale

Bank of Kigali is the largest subsidiary of BK Group, a holding company with three other subsidiaries, namely BK General Insurance, BK TechHouse and BK Capital Ltd. The smaller subsidiaries are growing revenue contributions and represented approximately 5% of the profit before tax ('PBT') to the group in FY20. 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 ratings on the bank balances its position as a market leader in Rwanda, strong capitalisation, sound funding structure, good liquidity with its modest risk position.

Bank of Kigali is the largest bank in Rwanda's relatively overbanked and increasingly competitive banking sector and had strong market shares of approximately 30.8% by total assets, 36.2% of loans, and 30.1% by customer deposits as of March 2021. While geographical diversification is limited to Rwanda, it has the broadest geographical reach within the country, relative to peers through physical branches, ATM's, POS and agents. Business lines are moderately diversified in the Rwandan market context, with corporate banking accounting for 70% of revenues and retail accounting for 16%. The bank's revenue stability, augmented by sustained year-on-year increases in both interest and non-interest income in the past five years, is viewed positively especially during this extended stress period.

GCR considers the bank to be well capitalised on the back of a GCR total capital ratio of 25.1% at FY20. We anticipate that the capital ratio will moderate slowly, as risk weighted asset growth broadly increases quicker than the internally generated capital (post dividends). We anticipate moderate loan growth of around 10% over the next couple of years,

however the increased impairments will likely raise the risk-weighting more. Profitability is expected to moderate but remain at robust levels, with return on assets expected to be around 2.5%-3% over the next two years.

The risk position of the bank is relatively weak compared with rated peers and a deterioration in the quality of the bank's loan book is noted. Annualised credit losses have averaged around 3.6% over the past five years with FY20 at 4.2%, which is high even in a regional context. In FY20, risk costs increased due to deterioration in asset quality coupled with a conservative macroeconomic overlay due to the COVID-19 pandemic. Given the severe economic pressures, cost of risk is expected to remain high for the next 12-18 months. The bank's nonperforming loans (NPL) ratio of around 6.7% is broadly in line with Rwandan peers, however its stronger than most of the Kenyan peer group. We expect NPLs to increase moderately going forward, because the bank is exposed to some vulnerable sectors such as transport and communication (19.5% of gross loans), hotels and restaurants (12.1%), and manufacturing (10.0%). The retail loan book (23% of gross loans) may also face some pressure, as only 45% of the retail loan book is collateralised. Overall, the bank had restructured over 43% of its loan book at FY20 but this has subsequently improved to around 14% of total loans in the first half of 2021. Positively, we consider loan loss reserving of c.105% or nearly 8% of total loans at FY20 to provide good coverage of expected losses. Foreign currency lending accounted for 14% of total loans at FY20 and is considered to be modest versus regional peers. The bank's short net-open position of 5% of shareholder funds at FY20 is considered to be ratings neutral.

The bank's funding is considered to be stable, with deposits making up 93% of the group's funding base at FY20. Though deposits are predominantly demand deposits at c.61%, they have historically been sticky. Furthermore, there is increasing diversification in the customer base. At FY20, the deposit base was split between large corporate (40.7%), SMEs (10.9%), NBAs (9.7%) and retail (24.5%). Despite, increasing diversification the deposit book is somewhat concentrated (like many Rwandan peers), with the top 20 depositors accounting for 29.3% of total depositors. Cost of funds was a modest 2.3% in FY20 (FY19: 2.0%). The bank's liquidity has been stable throughout the pandemic and is viewed to be good, with liquid asset covering total wholesale funding by 4.4 times and 31% of customer deposits at FY20.

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 outlook is stable. Despite the highly pressurised environment, we expect the bank's financial profile to remain resilient over the next two years. Capital is expected to range between 22.5% and 25%, cost of risk around 4.5%, and liquidity to remain robust.

Rating triggers

We could lower the rating if asset quality or capitalisation deteriorate at quicker than anticipated levels. Positive rating is unlikely in the current environment but improved internal capital generation against risk-weighted asset growth and better asset quality could improve the ratings.

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Financial Institutions, May 2019
GCR Ratings Scale, Symbols & Definitions, May 2019
GCR Country Risk Scores, August 2021
GCR Financial Institutions Sector Risk Score, September 2021

Ratings history

Bank of Kigali Plc						
Rating class	Review	Rating scale	Rating	Outlook	Date	
Long Term issuer	Initial	National	A+(RW)	Stable	October 2010	
	Last	National	AA+(RW)	Stable	September 2020	
Short Term issuer	Initial	National	A1(RW)	n.a	October 2010	
	Last	National	A1+(RW)	n.a	September 2020	

BK Group Plc						
Rating class	Review	Rating scale	Rating	Outlook	Date	
Long Term issuer	Initial/last	National	AA(RW)	Stable	November 2019	
Short Term issuer	Initial/last	National	A1+(RW)	n.a	September 2020	

Analytical Entity: Bank of Kigali Plc

Bank of Kigali is the largest subsidiary of BK Group, a holding company with three other subsidiaries, namely BK General Insurance, BK TechHouse and BK Capital Ltd. BK Group is a non-operating holding company that owns 100% of Bank of Kigali and the other subsidiaries. The Group has a government ownership through the Rwanda Social Security Board (RSSB), which holds a 34.3% stake as of March 2021. The Group is a publicly listed company on the Rwanda Stock Exchange with a secondary listing on the Nairobi Securities Exchange. Bank of Kigali is categorized as a domestic systemically important bank ("DSIB"), given its market share in the banking sector and impact likely to ensue in case of failure. The analysis on the bank has been accomplished on a group analytical approach given that the entity is crucial to the group from an operational and financial standpoint.

The long-term national scale rating accorded to BK Group (the non-operating holding company – 'NOHC') is one notch below the bank's rating to reflect the NOHC's structural subordination.

Operating Environment

The operating environment assessment is anchored by Bank of Kigali's c.100% exposure in Rwanda.

Country risk

The Rwanda country risk score was lowered to '3.5' in July 2020 from '3.75' previously to capture the increased external & fiscal risk, increased poverty levels, dependency on government spending and higher growth expectations albeit lower than historical levels as economies begin to open. The country is reliant on tourism, c.15.0% of GDP, and the general services sector. The impact of the COVID-19 pandemic on the economy was unprecedented, from a sustained GDP growth rate of c.7% over the last decade, 2020 GDP contracted by an estimated 2%. The fiscal pressure has increased with debt to GDP levels at 69.4% with over 70.0% thereof being external borrowings, signalling potential currency impacts.

Sector risk

The Rwandan Financial Institutions Sector Risk Score of '3.75' balances the weakening government fiscal position (government debt to GDP ratio is expected to increase to 80% by end of 2022 from 71% in 2020) with the banking sector's rising levels of non-performing loans (non-performing loans increased to 6.6% as at March 2021 and the cost

of risk reached a five year high of 3.6% in 2020). It also reflects the estimated high degree of restructured lending (c.20%) and relatively moderate foreign currency loans versus regional peers. Additionally, it factors in regulation and sector wide governance standards, which are deemed to be appropriate for its current levels of development and complexity. We do consider the sector to be somewhat overbanked given the size of the economy, noting that the top tier of the sector is controlled by a few players but that regional banks are increasingly competitive in the country. Positively, the banking sector appears well capitalised on average (c.20%), and profitability is solid and stable. Funding is largely deposit based, with limited wholesale and external funding, but some banks are reliant on interbank funding.

Business Profile

Competitive position

Market leadership with strong market control

Bank of Kigali's competitive position is supported by its sound market position, as the largest bank operating in a somewhat overbanked and increasingly competitive sector. At 1Q20, Bank of Kigali had approximately 30.1% deposit and 36.2% loan market shares in Rwanda. While geographical diversification is limited to Rwanda, it has the broadest geographical reach within the country relative to peers, through physical branches, ATM's, POS and agents. As at FY20, the bank had 25,607 corporate clients, 356,299 retail clients, 68 Branches, 97 ATMs, 2,813 POS and 2,341 agents.

Business diversification is moderately strong, in the Rwandan market context, with corporate banking accounting for 70% of revenues and retail accounting for 16%. However, the deposit and loan book reflect the core strength of the bank, traditional corporate banking based on ingrained client relationships across the domestic corporate sector. The business lines operating across corporate banking, retail banking, treasury and insurance continue to boost the competitiveness of the bank in the sector. The insurance business is growing moderately well with gross written premiums ("GWP") growth at 25% year-on-year in 2020 while contributing 3% to the Group's revenues. BK Capital revenues increased by 20% in FY20 driven by fees from advisory services, fund management, as well as investment income. Assets under management grew by nearly 32% year-on-year mainly driven private pension funds and the launch of unit trust fund "Aguka". GCR expects the bank to maintain the top position in the market over the rating horizon, albeit under increasing competition, augmented by its well-established brand.

The bank has achieved good revenue growth over the past 4-5 years. The bank's revenue stability as amplified by the sustained year-on-year increases in both interest and non-interest income in the past five years is viewed positively especially during this extended stress period. Non-interest revenues contribute 20% to total operating revenues on average and we view this revenue component as crucial for revenue growth and stability moving forward. Net interest margins have remained at a competitive range of 9.5%-11.5% given the relatively cheaper cost of funding. We expect operating revenue growth to remain stable and average around 10% in the next 12-18 months.

Going forward the bank's strategy is to grow the retail business through transactional revenues while targeting one million customers over the next couple of years. Automation of processes and integration of BK Group's systems will boost these efforts and lead to enhanced operational efficiencies.

Management and governance

Management and governance is considered neutral to the ratings. We consider the management and governance structure to be appropriate.

Financial Profile

Capital and Leverage

Strong capital position to support growth

The capitalization of the bank is a positive ratings factor. GCR considers the bank to be well capitalised on the back of a GCR total capital ratio of 25.1% at FY20. We anticipate that the capital ratio will remain relatively stable as risk weighted asset ("RWA") growth broadly matches growth in the internally generated capital (post dividends). In FY20, RWA expanded by 39% to FRw921.9bn while internal capital generation capacity stood at 17.0%. We expect capital levels to remain adequate due to the easing operating environment pressures and recovery signs in the economy. However, the bank is likely to continue experiencing elevated balance sheet risks cutting back on earnings due to increased cost of risk. Profitability is expected to recover, with return on assets expected to be around 2.5%-3.0% over the next two years.

Our forecast factors in the following over the next 12-18 months:

- Loan book growth of 10% in 2021 and 2022.
- Core earnings to adjusted assets to rebound to 3.3% and 3.7% in 2021 and 2022, respectively, from 2.7% in 2020.
- Cost of risk to remain elevated at levels of 4%-5% over the next 12-18 months.
- We are expecting operating revenue growth to be broadly stable over the next 12-18 months.
- Costs are expected to be well controlled, with cost to income stable at around 30%.

Table 1: Capital and Leverage

	2022(f)	2021 (e)	2020	2019	2018
GCR Total Capital to RWA (%)	25.9%	26.7%	25.1%	31.5%	34.5%
Core Earnings to adjusted assets (%)	3.7%	3.3%	2.7%	3.4%	2.9%

e: GCR expectation; f: GCR forecast.

Risk

Relatively weaker risk position due to higher non-performing loans

The risk position of the bank is relatively weak compared with rated peers and a deterioration in the quality of the bank's loan book is noted. Annualised credit losses have averaged around 3.6% over the past five years with FY20 at 4.2%, which is high even in a regional context. In FY20, risk costs increased due to deterioration in asset quality coupled with a conservative macroeconomic overlay due to the COVID-19 pandemic. Given the severe economic pressures, cost of risk is expected to remain high for the next 12-18 months. The bank's nonperforming loans ratio of around 6.7% is broadly in line with Rwandan peers, however, it is stronger than most of the Kenyan peer group.

We expect NPLs to increase moderately, settling at around 7.0% and credit losses at 4.5% in the next 12-18 months. The bank remain exposed to some vulnerable sectors such as transport and communication (19.5% of gross loans), hotels and restaurants (12.1%), and manufacturing (10.0%). The retail loan book (23% of gross loans) may also face some pressure, as only 45% of the retail loan book is collateralised. Overall, the bank had restructured over 43% of its loan book at FY20 but this has subsequently improved to around 14% of total loans in the first half of 2021. Positively, we consider loan loss reserving of c.105%, or nearly 8% of total loans at FY20, to provide good coverage of expected losses. Additionally, the easing operating environment pressures and recovery in key sectors may mitigate deterioration in asset quality.

Foreign currency lending accounted for 14% of total loans at FY20 and is modest versus regional peers with FX loans at 46% of FX deposits. The bank's short net-open position of 5% of shareholder funds at FY20 is considered to be ratings neutral.

Table 2: Risk Position

	2022(f)	2021(e)	2020	2019	2018
New loan loss provisions to average customer loans (%)	4.0%	4.9%	4.5%	4.4%	2.1%
Loan loss reserves to non-performing loans (%)	141.2%	115.2%	105.2%	148.1%	100.2%
Gross non-performing loans to gross customer loans (%)	6.6%	7.1%	7.8%	4.5%	5.4%
FX loans to total loans (%)	15.0%	15.0%	14.3%	16.5%	18.5%

e: GCR expectation; f: GCR forecast.

Funding and Liquidity

The bank's funding is considered to be stable, with customer deposits making up 93% of the group's funding base at FY20. Though deposits are predominantly demand deposits at c.61%, they have historically been sticky providing funding stability. Furthermore, there is increasing diversification in the customer base among corporates, SMEs, and retail customers. At FY20, the deposit base was split between large corporate (40.7%), SMEs (10.9%), NBAs (9.7%) and retail (24.5%). Despite, increasing diversification, the deposit book is somewhat concentrated (like many Rwandan peers), with the top 20 depositors accounting for 29.3% of total depositors. Cost of funds was a modest 3.8% in FY20 (FY19: 3.1%).

The bank's liquidity has been stable throughout the pandemic and is viewed to be good, with liquid assets covering total wholesale funding by 4.4 times and 31% of customer deposits at FY20.

Table 3: Funding and Liquidity

	2022(f)	2021(e)	2020	2019	2018
Customer loans to total deposits (%)	109%	104%	101%	104%	101%
Total deposits to funding base (%)	94%	94%	93%	94%	92%
GCR liquid assets to customer deposits (%)	33%	32%	36%	34%	37%
GCR liquid assets to total wholesale funding (x)	>4x	>4x	4.4x	5x	4x

e: GCR expectation; f: GCR forecast.

Comparative Profile

The comparative profile is a neutral component for the ratings.

Peer analysis

The peer analysis is neutral to the ratings.

Group support

Group support is not applicable to the ratings.

Rating Adjustment Factors

Structural adjustments

Structural adjustments have been made to the Anchor Credit Evaluator ("ACE") in arriving at the final ratings of BK Group (the non-operating holding company – 'NOHC').

Instrument ratings

No adjustments for instrument ratings are applicable.

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

Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Capital	The sum of money that is invested to generate proceeds.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
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.
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
Income	Money received, especially on a regular basis, for work or through investments.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
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	The party indebted or the person making repayments for its borrowings.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
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.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
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.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.
Short Term	Current; ordinarily less than one year.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the rating 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 party. The rating was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

The rated entity participated in the rating process via video conference 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 rating included:

- Audited financial results as at 31 December 2020;
- Unaudited financial results as at 31 March 2021;
- Banking sector information;
- A breakdown of facilities available and related counterparties;
- Industry comparative data.

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