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Bank of Kigali

Bank of Kigali: 2Q 20 earnings improve on lower cost of risk

Bank of Kigali **HOLD**

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EARNINGS REPORT

- Lower operating costs support earnings. Cost to income ratio falls to an impressive 35.8%, better than industry average
- Management upbeat about H2 20 as loan book under Covid-19 moratorium halves
- Cost of risk set to remain stable into H2 20 as coverage level soars and risk outlook improves

Bank of Kigali released Q2 20 results with quarterly PAT up 39% yoy. The bank recorded a lower loan loss provision charge in Q2 on account of a noted improvement in Covid-19 impacted loans and present high coverage levels (above 100%). Operating costs also reduced significantly, leading the cost to income ratio to fall to 35.8%, below management's target of 40-50%.

Management noted the quarter coincided with lockdown in Rwanda, hence the bank incurred lower expenditure. Non-interest revenue performed poorly, declining 6% yoy, following the waiving of fees on digital transactions and lower import and export activity. Overall, management seems upbeat about H2 20 and no longer expects the 30-40% decline in PAT it had set out in Q1 20.

We retain our HOLD recommendation on Bank of Kigali. We believe the bank is better positioned than peers to benefit from the impending economic recovery. This has already been demonstrated by market share acquisition. The bank is also well prepared on the digital aspect to accommodate rising transactions and customer uptake. This, coupled with a better than industry cost base and asset quality, should support superior profitability.

Outlook

1. Management has turned positive since Q1 20, with its portfolio under Covid-19 moratorium down to 20% from 40% with clients resuming normal payments.

2. Target loan and deposit growth for FY 20 is at 10-20% and 15-25% respectively with management banking on recovery to boost balance sheet growth.

3. The net interest margin outlook is 10.5-11.0%, with the regulator keen on keeping interest rates low to support private sector credit growth.

4. The cost to income ratio is targeted at 40-50%, with the lockdown having helped to accelerate adoption of cashless transactions. The only expenses expected going forward include continued infrastructure support and Covid-19 related expenses. These however will not increase the cost to income ratio significantly.

5. The FY 20 target for return on equity is at 15-20%. Achieving this will depend heavily on how the economic recovery pans out in H2 20. In the first half of the year, the bank recorded an ROE of 14.2%.
6. The cost of risk outlook is at 3-5%, lower than the 4.6% recorded in H1 20. Management has seen some improvement in the Covid-19 impacted loan book and has already surpassed >100% NPL coverage, hence any cost of risk increase will mainly be as a result of a weaker loan book rather than additional precautionary provision charges. The NPL ratio outlook is below 8%. With the regulator having allowed loans to be restructured up to four times and the economy improving, this is likely achievable.

Key positives

1. **Operating costs declined 7% yoy**. The cost to income ratio declined to 35.8% from 39.3% in Q2 19. The bank incurred lower expenses during the lockdown.
2. **Loan loss provision charge declined 28% yoy** following a decline in NPL ratio to 5.6% from 6.4% in Q2 19. NPL coverage increased to 117% from 95%, with management cognisant of the risks of the pandemic. In our East African banks coverage, Bank of Kigali has the highest NPL coverage ratio, with other banks trending well below 90%. So far, the bank has restructured 37% of its loan book, with management noting that restructuring requests have declined significantly.
3. **Strong balance sheet growth with loans and deposits up 22% yoy and 36% yoy** respectively. The retail and business banking segments recorded 13% and 23% increases in customer deposits ytd. Net interest margin declined to 9.5% from 11.4% in 2Q 19. Management noted that the bank had some bulk disbursements at the end of the quarter.

Key negative

1. **Non-interest revenue fell 6% yoy**. Fee and commission income fell 19% following the cut in fees in digital channel transactions. Forex income, down 4% yoy, was affected by reduced economic activity. The insurance arm however recorded good performance with profits up 22% yoy, riding on a 12% yoy increase in premiums and a 27% yoy jump in underwriting profit. We expect the insurance arm to continue supporting earnings as the bank uses its access to the value chain in both corporate and retail clients to be able to push its insurance products.

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