

Al Khalij Commercial Bank (KCBK)

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	QR11.29	Target Price	QR15.00
Implied Upside	+32.9%		

In-Line 1Q2018; Margins Expand

Al Khalij Commercial Bank is one of the smallest banks domestically. In terms of loans (~4% market share as of 2017), KCBK is one of the smallest of the five-listed conventional banks (6th among the eight-listed banks). KCBK has one of the lowest RoEs (8.0% 2017) among listed banks and it is below its cost of equity of 12.58%. Based on average RoE of 12.41% within our forecast horizon vs. cost of equity of 12.58%, the bank is generating economic losses.

Highlights

- **KCBK QoQ surge in net income driven by a significant drop in provisions & impairments; YoY growth in profitability was a result of better operating income (due to higher NII), lower opex and provisions.** KCBK reported net income of QR169.5mn (in-line with our estimate of QR160.1mn) surging by 74.8% QoQ (+5.3% YoY).
- **Operating efficiency continued its positive trajectory which resulted in strong JAWS.** Revenue grew by 11.5% QoQ (+1.2% YoY) while opex moved up by 2.0% QoQ (declined by 3.2% YoY). As a result KCBK generated JAWS of 9.6% and 4.4% QoQ and YoY, respectively. Moreover, C/I ratio declined to 25.7% in 1Q2018 vs. 28.1% in 4Q2017 (26.8% in 1Q2017). Management has been delivering on its efficiency target. Going forward we expect further improvement in the C/I ratio mainly through topline growth.
- **Margins improved sequentially and on a YoY basis.** Net interest income increased by 4.5% QoQ (+5.7% YoY) to QR244.0mn, in-line with our estimate of QR236.8mn (+3.0% variation). NIM expanded by 14bps QoQ and 21bps YoY to 1.86%. Yields moved up by 19bps QoQ (+43bps YoY) while CoFs remained flat (+15bps YoY), leading the expansion in margins.
- **Gross loans remained flat while deposits dropped.** Gross loans remained flat QoQ at QR36.1bn while deposits receded by 3.8% to QR31.4bn. As such, LDR moved up to 109% vs. 107% in at the end of 2017. Including EMTN as a source of long-term funding, LDR works out to 98%.
- **NPLs remained stable, CoR dropped.** The bank's NPLs remained stable QR703.3mn. As such, the NPL ratio also remained constant at 1.95% vs. 1.94% at the end of 2017. Moreover, the coverage ratio (coverage of stage 3 loans/NPLs) remained healthy at 106%. We expect the coverage ratio to continuously increase as management exercises prudent risk control. CoR improved, declining to 50bps vs. 84bps in 2017. Under IFRS 9, stage 1 loans represent 87% of total loans while stage 2 loans are 11%.
- **IFRS 9 negatively impacted KCBK's equity base.** The bank disclosed ECLs of QR1bn which was netted against equity in 1Q2018. ECLs negatively impacted equity by 13%.
- **Tier 1 capital negatively impacted by IFRS 9; however capital position remains strong.** KCBK ended 1Q2018 with a CET1 ratio of 12.8% and Tier-1 ratio of 16.6% (including AT1 capital) vs. 14.2% and 16.7% at the end of 2017, respectively. ECLs of QR1bn shaved off 129bps from CET1 ratio.

Catalysts

- **Visible progress in management's strategy:** 1) an expansion of attributable RoE beyond 12% (2018e and 2019e RoE: 8.0% and 10.7%, respectively) & 2) improvement in the liquidity of the stock.

Recommendation, Valuation and Risks

- **Recommendation and valuation: We maintain our Price Target at QR15.00.** KCBK trades at P/TB and P/E of 0.7x and 7.8x on our 2018 estimates, respectively.
- **Risks:** 1) Geopolitical Factors/issues, 2) KCBK's market share gains do not materialize; 3) possible asset quality concerns and 4) concentration risk.

Key Financial Data and Estimates

	FY2017	FY2018e	FY2019e	FY2020e
EPS (QR)	1.38	1.43	1.71	1.96
EPS Growth (%)	28.8	3.9	19.6	14.9
P/E (x)	8.2	7.9	6.6	5.7
Tangible BVPS (QR)	17.0	15.1	16.0	17.2
P/TB (x)	0.7	0.7	0.7	0.6
DPS (QR)	0.75	0.75	0.75	1.00
Dividend Yield (%)	6.6	6.6	6.6	8.9

Source: Company financials, QNBFS Research; Note: All data based on current number of shares

Key Data

Current Market Price (QR)	11.29
Dividend Yield (%)	6.6
Bloomberg Ticker	KCBK QD
ADR/GDR Ticker	N/A
Reuters Ticker	KCBK.QA
ISIN	QA000A0M6MD5
Sector*	Banks & Fin. Svcs.
52wk High/52wk Low (QR)	15.20/10.81
3-m Average Volume ('000)	182.9
Mkt. Cap. (\$ bn/QR bn)	1.1/4.1
Shares Outstanding (mn)	360.0
FO Limit* (%)	49.0
Current FO* (%)	10.9
1-Year Total Return (%)	-17.6
Fiscal Year End	December 31

Source: Bloomberg (as of April 22, 2018), *Qatar Exchange (as of April 19, 2018); Note: FO is foreign ownership

Shahan Keushgerian

+974 4476 6509
shahan.keushgerian@qnbfs.com.qa

Saugata Sarkar, CFA, CAIA

+974 4476 6534
saugata.sarkar@qnbfs.com.qa

Detailed Financial Statements

Income Statement (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Net Interest Income	984	1,021	1,110	1,204
Fees & Commissions	182	186	200	182
FX Income	39	43	46	52
Other Income	9	10	12	14
Non-Interest Income	231	239	259	248
Total Revenue	1,215	1,259	1,369	1,452
Operating Expenses	(335)	(323)	(342)	(376)
Net Operating Income	880	936	1,027	1,076
Net Provisions & Impairments	(319)	(344)	(330)	(284)
Net Profit Before Taxes & Non-Recurring Items	562	592	697	792
Non-Recurring Income	-	-	-	-
Net Profit Before Tax	562	592	697	792
Tax	(11)	(23)	(26)	(30)
Net Profit (Headline/Reported)	551	570	671	762
Interest Payment on AT1 Note	(55)	(55)	(55)	(55)
Social & Sports Contribution Fund	(14)	(14)	(17)	(19)
Net Profit (Attributable)	482	500	599	688

Source: Company financials, QNBFS Research

Balance Sheet (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Assets				
Cash & Balances with Central Bank	2,587	2,696	2,013	2,706
Interbank Loans	6,617	6,471	4,832	5,863
Net Investments	12,506	12,393	11,553	10,383
Net Loans	35,094	36,119	39,177	43,982
Other Assets	689	542	588	616
Net PP&E	235	248	247	247
Goodwill & Other Intangibles	156	143	143	125
Total Assets	57,885	58,613	58,553	63,922
Liabilities				
Interbank Deposits	10,597	8,624	4,107	4,033
Customer Deposits	32,683	35,951	40,265	45,097
Term Loans & Borrowings	5,743	5,656	5,656	5,656
Other Liabilities	1,570	1,798	1,611	1,804
AT1 Perpetual Bonds	1,000	1,000	1,000	1,000
Total Liabilities	51,593	53,029	52,639	57,590
Total Shareholders' Equity	6,292	5,585	5,914	6,332
Total Liabilities & Shareholders' Equity	57,885	58,613	58,553	63,922

Source: Company financials, QNBFS Research

Ratios/Financial Indicators	FY2017	FY2018e	FY2019e	FY2020e
Profitability (%)				
RoAE (Attributable)	7.8	8.4	10.4	11.2
RoAA (Attributable)	0.8	0.9	1.0	1.1
RoRWA (Attributable)	0.9	1.0	1.1	1.2
NIM (% of IEAs)	1.8	1.9	2.0	2.1
NIM (% of RWAs)	2.4	2.6	2.7	2.7
NIM (% of AAs)	1.7	1.8	1.9	2.0
Spread	1.7	1.6	1.7	1.7
Efficiency (%)				
Cost-to-Income (Headline)	27.6	25.6	25.0	25.9
Cost-to-Income (Core)	27.8	25.8	25.2	26.1
Liquidity (%)				
LDR	107	100	97	98
Loans/Assets	60.6	61.6	66.9	68.8
Cash & Interbank Loans-to-Total Assets	15.9	15.6	11.7	13.4
Deposits to Assets	56.5	61.3	68.8	70.6
Wholesale Funding to Loans	46.3	39.5	24.9	22.0
IEAs to IBLs	117.6	117.1	117.5	118.5
Asset Quality (%)				
NPL Ratio	1.94	2.30	2.10	1.50
NPL to Shareholders' Equity	11.10	15.64	14.61	10.92
NPLs to Tier-1 Capital	10.49	14.15	13.30	10.10
Coverage Ratio	118	115	131	183
ALL/Average Loans	2.3	5.0	5.0	4.8
Cost of Risk	84	88	78	60
Capitalization (%)				
Tier-1 Ratio	16.7	15.6	15.5	14.5
CAR	16.7	15.6	15.5	14.5
Tier-1 Capital to Assets	11.5	10.5	11.1	10.7
Tier-1 Capital to Loans	19.0	17.1	16.6	15.6
Tier-1 Capital to Deposits	20.4	17.2	16.1	15.2
Leverage (x)	9.2	10.5	9.9	10.1
Growth (%)				
Net Interest Income	7.9	3.7	8.8	8.4
Non-Interest Income	-6.9	3.5	8.6	-4.2
OPEX	-1.9	-3.5	6.0	9.8
Net Operating Income	7.5	6.4	9.7	4.8
Net Income (Reported/Headline)	29.1	3.5	17.8	13.6
Loans	-0.2	2.9	8.5	12.3
Deposits	1.5	10.0	12.0	12.0
Assets	-4.5	1.3	-0.1	9.2
RWAs	-3.1	-0.6	5.8	12.4

Source: Company financials, QNBFS Research

Recommendations

Based on the range for the upside / downside offered by the 12 - month target price of a stock versus the current market price

OUTPERFORM	Greater than +20%
ACCUMULATE	Between +10% to +20%
MARKET PERFORM	Between -10% to +10%
REDUCE	Between -10% to -20%
UNDERPERFORM	Lower than -20%

Risk Ratings

Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals

R-1	Significantly lower than average
R-2	Lower than average
R-3	Medium / In-line with the average
R-4	Above average
R-5	Significantly above average

Contacts

Saugata Sarkar, CFA, CAIA

Head of Research

Tel: (+974) 4476 6534

saugata.sarkar@qnbfs.com.qa

Mohamed Abo Daff

Senior Research Analyst

Tel: (+974) 4476 6589

mohd.abodaff@qnbfs.com.qa

Shahan Keushgerian

Senior Research Analyst

Tel: (+974) 4476 6509

shahan.keushgerian@qnbfs.com.qa

QNB Financial Services Co. WLL

Contact Center: (+974) 4476 6666

PO Box 24025

Doha, Qatar

Zaid Al Nafsoosi, CMT, CFTe

Senior Research Analyst

Tel: (+974) 4476 6535

zaid.alnafsoosi@qnbfs.com.qa

Disclaimer and Copyright Notice: This publication has been prepared by QNB Financial Services Co. WLL ("QNBFS") a wholly-owned subsidiary of Qatar National Bank Q.P.S.C ("QNB"). QNBFS is regulated by the Qatar Financial Markets Authority and the Qatar Exchange QNB is regulated by the Qatar Central Bank. This publication expresses the views and opinions of QNBFS at a given time only. It is not an offer, promotion or recommendation to buy or sell securities or other investments, nor is it intended to constitute legal, tax, accounting, or financial advice. QNBFS accepts no liability whatsoever for any direct or indirect losses arising from use of this report. Any investment decision should depend on the individual circumstances of the investor and be based on specifically engaged investment advice. We therefore strongly advise potential investors to seek independent professional advice before making any investment decision. Although the information in this report has been obtained from sources that QNBFS believes to be reliable, we have not independently verified such information and it may not be accurate or complete. QNBFS does not make any representations or warranties as to the accuracy and completeness of the information it may contain, and declines any liability in that respect. For reports dealing with Technical Analysis, expressed opinions and/or recommendations may be different or contrary to the opinions/recommendations of QNBFS Fundamental Research as a result of depending solely on the historical technical data (price and volume). QNBFS reserves the right to amend the views and opinions expressed in this publication at any time. It may also express viewpoints or make investment decisions that differ significantly from, or even contradict, the views and opinions included in this report. This report may not be reproduced in whole or in part without permission from QNBFS.

COPYRIGHT: No part of this document may be reproduced without the explicit written permission of QNBFS.