

Al Khalij Commercial Bank (KCBK)

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	QR17.70	Target Price	QR19.00
Implied Upside	+7.3%		

3Q2016 Disappoints, Lowering Estimates

Al Khalij Commercial Bank is one of the smallest banks domestically with potential to grow. In terms of loans (~4% market share as of 2014), 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 (8.1% 2016e) among listed banks and it is below its cost of equity of 11.52%.

Highlights

- KCBK misses estimates; profitability drops on the back of a surge in provisions.** KCBK reported a net profit of QR104.78mn in 3Q2016, declining by 36.2% QoQ and YoY, significantly falling short of expectations. *However, net operating income before provisions was in-line at QR202.75mn vs. our estimate of QR202.05mn.*
- KCBK's QoQ performance was impacted by a spike in provisions and overall weak revenue.** The bank posted net interest income of QR218.42mn, declining by 3.8% QoQ (down 7.2% YoY) on the back of margin pressure. *KCBK's NIM receded by ~6bps and ~24bps to 1.58%, QoQ and YoY, respectively. The bank's cost of funds increased far more than its yield on assets. Moreover, Fees & commissions declined by 25.8% QoQ (down 5.0% YoY) to QR42.02mn vs. QR56.64mn in 2Q2016. YoY profitability declined due to the same reasons as QoQ factors.*
- Drop in opex was the main reason for the marginal increase net operating income.** KCBK posted opex of QR79.59mn, retrenching by 14.4% QoQ (down 20.1% YoY). Thus net operating income moved up by 1.5% QoQ (+9.2% YoY). The bank's efforts to be cost-efficient has materialized as evidenced by its cost-to-income ratio. *C/I improved, declining to 28.2% in 3Q2016 vs. 31.8% in 2Q2016 and 34.9% in 3Q2015 (KCBK's C/I used to be 40% and beyond in 2014 and earlier years).*
- LDR remains elevated.** Net loans expanded by 2.7% QoQ (+8.5% YTD) to QR36.28bn, while customer deposits exhibited flattish performance (down 0.4% QoQ and 0.8% YTD) at QR30.68bn. As a result, KCBK's LDR jumped to 118% vs. 115% in 2Q2016 (108% at the end of 2015).
- Asset quality under stress.** KCBK's asset quality deteriorated with NPLs surging by 56.9% YTD to QR453.1mn. Moreover the NPL ratio climbed up to 1.2% in 3Q2016 vs. 0.9% at the end of 2015. On the other hand coverage ratio improved to 94% from 2015's 89%. The increase in NPLs and spike in provisions signals further asset quality deterioration on the horizon.
- Capitalization remains robust.** KCBK's CET1 ratio and Tier-1 ratio stood at 13.4% and 15.8%, respectively at the end of 3Q2016 vs. 13.8% at the end of 2015. The QR1.0bn perpetual Tier-1 noted issued in 2Q2016 enhanced the bank's capital position.

Catalysts

- Beyond a stabilization/recovery in oil prices, the following developments could be perceived positively by the market: Visible progress in management's strategy:** 1) a consistent rise in market share; 2) an expansion of attributable RoAE beyond 12% (2016e and 2017e RoAE: 8.1% and 8.0%, respectively) and 3) announcements/newsflow on infrastructure projects.

Recommendation, Valuation and Risks

- Recommendation and valuation: We maintain our Price Target of QR19.00.** *We made revisions to our 2016, 2017 and 2018 estimates. We lowered total revenue and increased provisions. KCBK trades at P/TB and P/E of 1.0x and 12.8x on our 2017 estimates, respectively.*
- Risks:** 1) Depressed oil prices remains the biggest risk for KCBK and the banking sector; 2) KCBK's market share gains do not materialize; 3) Untested loan book and asset quality; 4) concentration risk and 5) LDR requirement from the QCB could create short-term issues.

Key Financial Data and Estimates

	FY2015	FY2016e	FY2017e	FY2018e
Attributable EPS (QR)	1.69	1.36	1.38	1.77
EPS Growth (%)	11.1	-19.5	1.2	28.2
P/E (x)	10.4	13.0	12.8	10.0
Tangible BVPS (QR)	16.2	16.6	17.0	17.7
P/TB (x)	1.1	1.1	1.0	1.0
DPS (QR)	1.00	1.00	1.00	1.00
Dividend Yield (%)	5.6	5.6	5.6	5.6

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

Key Data

Current Market Price (QR)	17.70
Dividend Yield (%)	5.6
Bloomberg Ticker	KCBK.QD
ADR/GDR Ticker	N/A
Reuters Ticker	KCBK.QA
ISIN	QA000A0M6MD5
Sector*	Banks & Financial Svcs.
52wk High/52wk Low (QR)	21.73/15.71
3-m Average Volume ('000)	65.7
Mkt. Cap. (\$ bn/QR bn)	1.8/6.4
Shares Outstanding (mn)	360.0
FO Limit* (%)	49.0
Current FO* (%)	10.6
1-Year Total Return (%)	(12.5)
Fiscal Year End	December 31

Source: Bloomberg (as of October 20, 2016), *Qatar Exchange (as of October 20, 2016); Note: FO is foreign ownership

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Changes to Estimates

	2016			2017			2018		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Net Interest Income	1,012	894	-11.6%	1,119	937	-16.2%	1,267	1,049	-17.2%
Non Interest Income	241	263	9.0%	262	261	-0.5%	254	290	14.1%
Total Revenue	1,253	1,157	-7.7%	1,381	1,198	-13.2%	1,521	1,338	-12.0%
Net Operating Income	857	808	-5.7%	975	852	-12.6%	1,100	964	-12.4%
Net Income (Reported/Headline)	691	559	-19.2%	773	562	-27.3%	900	706	-21.6%
Net Income (Attributable)	615	491	-20.1%	695	495	-28.8%	819	634	-22.5%

Detailed Financial Statements

Ratios/Financial Indicators	FY2015	FY2016e	FY2017e	FY2018e
Profitability (%)				
RoAE (Attributable)	10.4	8.1	8.0	9.9
RoAA (Attributable)	1.1	0.8	0.8	0.9
RoRWA (Attributable)	1.2	1.0	0.9	1.0
NIM (% of IEAs)	1.9	1.7	1.6	1.6
NIM (% of RWAs)	2.6	2.3	2.2	2.2
NIM (% of AAs)	1.7	1.5	1.5	1.5
Spread	1.9	1.6	1.5	1.4
Efficiency (%)				
Cost-to-Income (Headline)	34.2	30.1	28.9	28.0
Cost-to-Income (Core)	34.5	30.6	29.2	28.5
Liquidity (%)				
LDR	108	116	110	108
Loans/Assets	59.1	62.0	59.8	61.3
Cash & Interbank Loans-to-Total Assets	12.5	9.6	10.8	9.1
Deposits to Assets	54.6	53.5	54.2	56.8
Wholesale Funding to Loans	55.1	50.4	54.3	49.5
IEAs to IBLs	115.0	117.7	116.1	116.4
Asset Quality (%)				
NPL Ratio	0.86	1.28	1.50	1.20
NPL to Shareholder's Equity	4.82	7.75	9.51	8.16
NPLs to Tier-1 Capital	5.53	7.18	8.83	7.60
Coverage Ratio	89	103	124	109
ALL/Average Loans	0.8	1.4	1.9	1.4
Cost of Risk	27	68	67	52
Capitalization (%)				
Tier-1 Ratio	13.8	16.1	15.2	14.1
CAR	13.8	16.1	15.2	14.1
Tier-1 Capital to Assets	9.2	11.2	10.3	9.8
Tier-1 Capital to Loans	15.6	18.1	17.3	16.0
Tier-1 Capital to Deposits	16.9	20.9	19.1	17.3
Leverage (x)	9.5	9.6	10.4	10.9
Growth (%)				
Net Interest Income	23.3	-3.2	4.8	11.9
Non-Interest Income	-16.8	19.5	-0.7	11.1
OPEX	-8.1	-10.9	-0.5	8.1
Net Operating Income	28.0	7.4	5.3	13.1
Net Income (Reported/Headline)	11.1	-10.7	0.6	25.5
Loans	24.4	9.4	6.4	12.6
Deposits	12.7	2.0	12.0	15.0
Assets	10.5	4.2	10.4	9.8
RWAs	14.7	8.8	7.7	12.6

Source: Company data, QNBFS estimates

Income Statement (In QR mn)	FY2015	FY2016e	FY2017e	FY2018e
Net Interest Income	924	894	937	1,049
Fees & Commissions	190	209	218	233
FX Income	20	32	31	33
Other Income	10	21	12	24
Non-Interest Income	220	263	261	290
Total Income	1,144	1,157	1,198	1,338
Operating Expenses	(391)	(348)	(347)	(375)
Net Operating Income	753	808	852	964
Net Provisions & Impairments	(101)	(247)	(266)	(229)
Net Profit Before Taxes & Non-Recurring Items	651	561	586	735
Non-Recurring Income	-	-	-	-
Net Profit Before Tax	651	561	586	735
Tax	(26)	(3)	(23)	(29)
Net Profit (Headline/Reported)	626	559	562	706
Interest Payment on AT1 Note		(55)	(55)	(55)
Social & Sports Contribution Fund	(16)	(13)	(13)	(16)
Net Profit (Attributable)	610	491	495	634

Source: Company data, QNBFS estimates

Balance Sheet (In QR mn)	FY2015	FY2016e	FY2017e	FY2018e
Assets				
Cash & Balances with Central Bank	1,973	2,524	2,120	2,438
Interbank Loans	5,098	3,155	4,948	4,064
Net Investments	15,275	15,776	18,128	20,303
Net Loans	33,447	36,585	38,932	43,852
Other Assets	511	640	701	526
Net PP&E	171	160	155	154
Goodwill & Other Intangibles	160	160	160	160
Total Assets	56,634	59,000	65,143	71,498
Liabilities				
Interbank Deposits	14,598	14,800	17,501	18,069
Customer Deposits	30,935	31,553	35,340	40,641
Term Loans & Borrowings	3,829	3,629	3,629	3,629
Other Liabilities	1,285	1,893	1,414	1,626
AT1 Perpetual Bonds		1,000	1,000	1,000
Total Liabilities	50,647	52,875	58,884	64,964
Total Shareholders' Equity	5,987	6,125	6,260	6,534
Total Liabilities & Shareholders' Equity	56,634	59,000	65,143	71,498

Source: Company data, QNBFS estimates

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

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