

### Al Khalij Commercial Bank (KCBK)

<b>Recommendation</b>	<b>MARKET PERFORM</b>	<b>Risk Rating</b>	<b>R-3</b>
<b>Share Price</b>	<b>QR12.05</b>	<b>Target Price</b>	<b>QR15.00</b>
<b>Implied Upside</b>	<b>+24.5%</b>		

### Decent 3Q2017, Modifying Estimates

Al Khalij Commercial Bank is one of the smallest banks domestically. In terms of loans (~4% market share as of 2016), KCBK is one of the smallest of the five-listed conventional banks (6<sup>th</sup> among the eight-listed banks). KCBK has one of the lowest RoEs (6.4% 2016) among listed banks and it is below its cost of equity of 11.52%. Based on average RoE of 11.10% within our forecast horizon vs. cost of equity of 11.52%, the bank is generating economic losses.

#### Highlights

- Net operating income (before provisions in-line, net profit misses our estimates on provisions.** Al Khalij Commercial Bank's (KCBK) registered net operating profit of QR238.1mn, in-line with our estimate of QR237.2mn. Reported net income of QR133.7mn missed our estimate of QR149.2mn (variation, -10%) due to provisions.
- KCBK's net profit declined by 15.8% QoQ (+27.6% YoY) due to a jump in provisions and impairments; YoY growth was driven by strong numbers across the board.** Net operating income grew by 13.5% QoQ (+17.5% YoY) to QR321.8mn, driven by 8% growth in revenue (QR321.8mn) coupled with 4.7% drop in opex (QR83.7mn). Growth in total revenue was attributed to positive f/x income and gains from investment securities vs. losses generated in 2Q2017. KCBK posted provisions and impairments of QR104.9mn in 3Q2017 QR50.7m in 2Q2017 (QR118.2mn in 3Q2016). The bank continued booking provisions to help it mitigate any future risks. We expect provisioning to continue in the foreseeable future. We model a CoR of 93bps & 83bps for 2018 and 2019, respectively. We expect CoR to eventually normalize at circa 35bps.
- Operating efficiency improved which resulted in strong JAWS.** C/I ratio declined to 26.0% in 3Q2017 vs. 29.5% in 2Q2017 (28.2% in 3Q2016). KCBK generated JAWS of 11.6% in 9M2017 as revenue grew by 6.8% while opex dropped by 4.8%.
- Margins contracted QoQ but significantly improved YoY.** Net interest income declined by 4.0% QoQ (+16.6% YoY) to QR254.7mn, in-line with our estimate (+1.6% variation). NIM contracted by 7bps QoQ (+29bps YoY) to 1.87%, respectively.
- Net Loans grew QoQ, deposits remained flat.** Net loans increased by 2.1% QoQ (+2.2% YTD) to QR35.9bn while deposits were flat QoQ at QR32.2bn (+0.1% YTD). As such, LDR elevated to 112% vs. 108% in 2Q2017 (106% in FY2016). We expect the LDR to drop to 100% by the end of 2019 as we model in deposit growth of 10% (2018) and 20% (2019). Moreover, we estimate loan growth of 5.7% and 10.1% in 2018 and 2019, respectively.
- Asset quality remained stable & manageable.** The bank's NPLs remained stable QoQ (+18.3% YTD). As such, the NPL ratio receded to 1.76% vs. 1.79% in 2Q2017 (1.52% at the end of 2016). Moreover, the coverage ratio further improved to 124% vs. 113% in 2Q (110% at the end 2017), which is positive. We expect the coverage ratio to continuously increase as management exercises prudent risk control.

#### 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) an expansion of attributable RoE beyond 12% (2018e and 2019e RoE: 8.4% and 9.5%, respectively)

#### 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 10.0x on our 2017 estimates, respectively.
- Risks:** 1) Geopolitical Factors/issues, 2) Depressed oil prices remains the biggest risk for KCBK and the banking sector; 3) KCBK's market share gains do not materialize; 4) Untested loan book and asset quality and 5) concentration risk.

#### Key Financial Data and Estimates

	FY2016	FY2017e	FY2018e	FY2019e
Attributable EPS (QR)	1.04	1.20	1.45	1.71
EPS Growth (%)	-38.6	15.6	20.4	18.3
P/E (x)	11.7	10.0	8.3	7.0
Tangible BVPS (QR)	16.3	16.9	17.6	18.6
P/TB (x)	0.7	0.7	0.7	0.6
DPS (QR)	0.75	0.75	0.75	1.00
Dividend Yield (%)	6.2	6.2	6.2	8.3

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

#### Key Data

Current Market Price (QR)	12.05
Dividend Yield (%)	6.2
Bloomberg Ticker	KCBK QD
ADR/GDR Ticker	N/A
Reuters Ticker	KCBK.QA
ISIN	QA000A0M6MD5
Sector*	Banks & Fin. Svcs.
52wk High/52wk Low (QR)	18.20/11.50
3-m Average Volume ('000)	28.9
Mkt. Cap. (\$ bn/QR bn)	1.2/4.3
Shares Outstanding (mn)	360.0
FO Limit* (%)	49.0
Current FO* (%)	10.5
1-Year Total Return (%)	-29.8
Fiscal Year End	December 31

Source: Bloomberg (as of October 26, 2017), \*Qatar Exchange (as of October 26, 2017); Note: FO is foreign ownership

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## Change in Estimates

	2017			2018			2019		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Net Interest Income	1,003	1,013	1.0%	1,074	1,082	0.8%	1,190	1,179	-0.9%
Non Interest Income	183	211	15.5%	244	227	-6.8%	271	243	-10.2%
Total Revenue	1,186	1,225	3.3%	1,264	1,310	3.6%	1,461	1,423	-2.6%
Net Operating Income	880	874	-0.7%	914	940	2.9%	1,124	1,020	-9.2%
Net Income (Reported/Headline)	456	499	9.4%	547	589	7.7%	727	687	-5.5%
Net Income (Attributable)	391	433	10.6%	480	521	8.5%	656	616	-6.1%

Source: QNBFS Research

## Detailed Financial Statements

Income Statement (In QR mn)	FY2016	FY2017e	FY2018e	FY2019e
Net Interest Income	913	1,013	1,082	1,179
Fees & Commissions	198	183	191	206
FX Income	31	17	19	20
Other Income	19	12	18	17
<b>Non-Interest Income</b>	<b>248</b>	<b>211</b>	<b>227</b>	<b>243</b>
<b>Total Revenue</b>	<b>1,160</b>	<b>1,225</b>	<b>1,310</b>	<b>1,423</b>
Operating Expenses	(341)	(351)	(369)	(403)
<b>Net Operating Income</b>	<b>819</b>	<b>874</b>	<b>940</b>	<b>1,020</b>
Net Provisions & Impairments	(403)	(356)	(328)	(306)
<b>Net Profit Before Taxes &amp; Non-Recurring Items</b>	<b>416</b>	<b>518</b>	<b>613</b>	<b>714</b>
Non-Recurring Income	-	-	-	-
<b>Net Profit Before Tax</b>	<b>416</b>	<b>518</b>	<b>613</b>	<b>714</b>
Tax	11	(20)	(23)	(27)
<b>Net Profit (Headline/Reported)</b>	<b>427</b>	<b>499</b>	<b>589</b>	<b>687</b>
Interest Payment on AT1 Note	(42)	(55)	(55)	(55)
Social & Sports Contribution Fund	(11)	(11)	(13)	(16)
<b>Net Profit (Attributable)</b>	<b>374</b>	<b>433</b>	<b>521</b>	<b>616</b>

Source: Company financials, QNBFS Research

Balance Sheet (In QR mn)	FY2016	FY2017e	FY2018e	FY2019e
<b>Assets</b>				
Cash & Balances with Central Bank	2,359	1,951	2,325	2,146
Interbank Loans	6,489	5,203	5,365	5,151
Net Investments	15,608	14,662	14,526	13,531
Net Loans	35,180	36,417	38,485	42,376
Other Assets	620	619	577	636
Net PP&E	191	229	233	232
Goodwill & Other Intangibles	150	144	138	138
<b>Total Assets</b>	<b>60,597</b>	<b>59,224</b>	<b>61,649</b>	<b>64,211</b>
<b>Liabilities</b>				
Interbank Deposits	12,899	12,159	11,243	6,376
Customer Deposits	32,195	32,517	35,769	42,923
Term Loans & Borrowings	6,137	5,370	5,370	5,370
Other Liabilities	2,333	1,951	1,788	1,717
AT1 Perpetual Bonds	1,000	1,000	1,000	1,000
<b>Total Liabilities</b>	<b>54,564</b>	<b>52,997</b>	<b>55,170</b>	<b>57,386</b>
<b>Total Shareholders' Equity</b>	<b>6,033</b>	<b>6,228</b>	<b>6,479</b>	<b>6,825</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>60,597</b>	<b>59,224</b>	<b>61,649</b>	<b>64,211</b>

Source: Company financials, QNBFS Research

Ratios/Financial Indicators	FY2016	FY2017e	FY2018e	FY2019e
<b>Profitability (%)</b>				
RoAE (Attributable)	6.2	7.1	8.2	9.3
RoAA (Attributable)	0.6	0.7	0.9	1.0
RoRWA (Attributable)	0.7	0.8	1.0	1.1
NIM (% of IEAs)	1.7	1.8	1.9	2.0
NIM (% of RWAs)	2.3	2.5	2.6	2.6
NIM (% of AAs)	1.6	1.7	1.8	1.9
Spread	1.6	1.7	1.6	1.6
<b>Efficiency (%)</b>				
Cost-to-Income (Headline)	29.4	28.6	28.2	28.3
Cost-to-Income (Core)	29.9	28.9	28.6	28.6
<b>Liquidity (%)</b>				
LDR	109	112	108	99
Loans/Assets	58.1	61.5	62.4	66.0
Cash & Interbank Loans-to-Total Assets	14.6	12.1	12.5	11.4
Deposits to Assets	53.1	54.9	58.0	66.8
Wholesale Funding to Loans	51.7	48.1	43.2	27.7
IEAs to IBLs	123.1	119.3	118.6	120.1
<b>Asset Quality (%)</b>				
NPL Ratio	1.52	1.77	2.00	2.10
NPL to Shareholders' Equity	9.03	10.58	12.18	13.35
NPLs to Tier-1 Capital	8.37	9.67	11.16	12.44
Coverage Ratio	110	121	121	111
ALL/Average Loans	1.7	2.2	2.5	2.4
Cost of Risk	103	93	83	73
<b>Capitalization (%)</b>				
Tier-1 Ratio	15.8	16.6	16.5	15.6
CAR	15.8	16.6	16.5	15.6
Tier-1 Capital to Assets	10.7	11.5	11.5	11.4
Tier-1 Capital to Loans	18.5	18.7	18.4	17.3
Tier-1 Capital to Deposits	20.2	21.0	19.8	17.1
Leverage (x)	10.0	9.5	9.5	9.4
<b>Growth (%)</b>				
Net Interest Income	-1.2	11.0	6.8	8.9
Non-Interest Income	12.7	-14.6	7.5	7.1
OPEX	-12.8	2.8	5.3	9.0
Net Operating Income	8.8	6.7	7.6	8.5
Net Income (Reported/Headline)	-31.8	16.9	18.2	16.6
Loans	5.2	3.5	5.7	10.1
Deposits	4.1	1.0	10.0	20.0
Assets	7.0	-2.3	4.1	4.2
RWAs	8.8	-0.1	4.2	9.6

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*

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

### Risk Ratings

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

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

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