

Kuwait International Bank (KIB)

Recommendation	ACCUMULATE	Risk Rating	R-3
Share Price	KWd 272	Target Price	KWd 319
Implied Upside/(Downside)	17.4		

Growth Not Priced In; Initiate with Accumulate

In 2007 Kuwait International Bank transitioned from Kuwait Real Estate Bank and in the process inherited a legacy real estate portfolio which became impaired during the 2009-2010 financial crisis. Hence, KIB has been de-risking its loan book and has reached a point where it is ready for double digit growth. KIB trades at a 14% and 24% discount to its historical P/B & P/E. Moreover the stock trades at a 2020e PEG of 0.8x (indicating the stock is relatively cheap). Furthermore, the market is pricing in a sustainable RoE of 10.3%, lower than our estimate of 11.7%. The stock has underperformed the entire banking sector over the last 12 months and we believe there is room for further upside. **We initiate coverage with an Accumulate rating and a PT of KWd (Fils) 319/sh.**

Highlights

- We pencil in a bottom-line CAGR of 13.3% in 2018-2023e vs. +9.6% (2013-2018).** The growth in net income is expected to be driven by net interest income (11.7% 5-year CAGR), non-funded income and flat credit provisions which we model to decrease by 0.9% vs. +4.4% (past 5 years). Having said this, there could be further upside to our estimates if KIB reduces provisions and books recoveries ahead of our model expectations. Like all Kuwaiti banks, general/precautionary provisions (imposed by the Central Bank) are much greater than specific provisions (86% of total reserves are general and not specific). As such, hefty reversals or netting these built up reserves against impairments can unlock value, boosting profitability (RoE > 12%).
- Corporate focused bank with double digit loans growth on the horizon.** KIB is a small-sized corporate focused bank and has a 3% market share in loans and deposits; we pencil in a loan book CAGR (2018-23e) of 10.9%. KIB has been de-risking its loan book since 2010 when the financial crisis adversely effected the bank. Consequently, the bank's legacy real estate portfolio was impaired. As such the bank shifted its focus to the government backed oil & gas sector along with other government-related projects, prime contractors and aviation leasing. Moreover, KIB has been actively participating in syndicated loans taking place in the GCC. When it comes to the real estate segment, the bank finances cash flow generating projects which it deems to be safe.
- Asset quality has markedly improved due to prudent risk control.** KIB has cleaned up its books since 2012 when the NPL ratio reached a high of 12.9% to 1.00% in 2018. The jump in NPLs took place during the 2008-10 financial crisis when investment companies and real estate firms defaulted on their debt (these were real estate legacy NPLs before KIB's transition from Kuwait Real Estate Bank). The NPL ratio declined through write-offs and de-risking the loan book. It is worth noting that KIB has been recovering a decent portion of write-offs (further recoveries would be a positive surprise for earnings) since 2014.
- Least efficient bank among peers; KIB's C/I ratio is at elevated levels.** We expect the efficiency ratio to steadily but not drastically decline in our forecast horizon. The reason that we do not anticipate a drop to the mid-30%'s as small banks tend to have high C/I ratios vs. large/mature banks. It should be noted that KIB has not been successful in generating positive JAWS as growth in opex has outpaced growth in revenue. However, we expect some positive JAWS going forward as the bank ramps up growth.
- \$300mn ADT1 Sukuk bolsters Tier-1 and supports growth:** KIB's assets grew by a CAGR (2012-18) of 9.6%, while the Tier-1 ratio dropped from 22.5% to 15.5%. The bank aims to grow further and as such issued ADT1 Sukuk of \$300mn. Hence, KIB's Tier-1 ratio is likely to jump from 15.5% in 2018 to 18.9% (2019e). Given the ADT1 issuance, we expect KIB's bottom-line to grow at a CAGR (2018-2023e) of 13.3% while maintaining an average Tier-1 ratio of 16.5%. Moreover, with this trend we expect the bank to generate a RoE of 10.7% and 11.6% by 2022 & 2023, respectively. It is worth noting that RoE could have been higher, but interest expense on the ADT1 eats away from the bottom-line by ~15%.

Catalysts

- 1) Further recoveries of write-offs & 2) Signs of continued loans and earnings growth.

Recommendation, Valuation and Risks

- Recommendation and valuation: We assign a Price Target of KWd 319 and an Accumulate rating.** KIB is trading at a 2019e P/B and P/E of 0.9x and 12.3x, respectively. The stock is trading at a PEG of 0.8x (which means the stock is relatively cheap) based on earnings of CAGR 13.3% (2018-2023e).
- Risks:** 1) Geo-political factors, 2) Unexpected asset quality deterioration, 3) CoR does not improve & the bank does not achieve its growth objectives.

Key Financial Data and Estimates

	2018	2019e	2020e	2021e
EPS (KWd)	22.4	22.1	25.1	29.2
Growth	17.8	-1.2	13.6	16.2
P/E (x)	12.6	12.3	10.8	9.3
BVPS (KWd)	281.3	292.9	307.0	324.2
P/B (x)	1.0	0.9	0.9	0.8
DPS (KWd)	11.0	11.0	12.0	12.0
Dividend Yield (%)	3.9	4.0	4.4	4.4

Source: Company data, QNB FS Research

Key Data

Current Market Price (KWd)	272
Dividend Yield (%)	3.9
Bloomberg Ticker	KIB KK
ADR/GDR Ticker	N/A
Reuters Ticker	KIB.KW
ISIN	KW0EQ0100069
Sector	Banks
52wk High/52wk Low (KWd)	330/219
3-m Average Volume (mn)	4.36
Mkt. Cap. (\$ bn/KWD bn)	0.8/0.3
Shares Outstanding (mn)	971,037.0
Current FO* (%)	4.87
1-Year Total Return (%)	+21.0
Fiscal Year End	December 31

Source: Bloomberg (as of July 23, 2019) *Boursa Kuwait (as of July 17, 2019); Note: FO is foreign ownership

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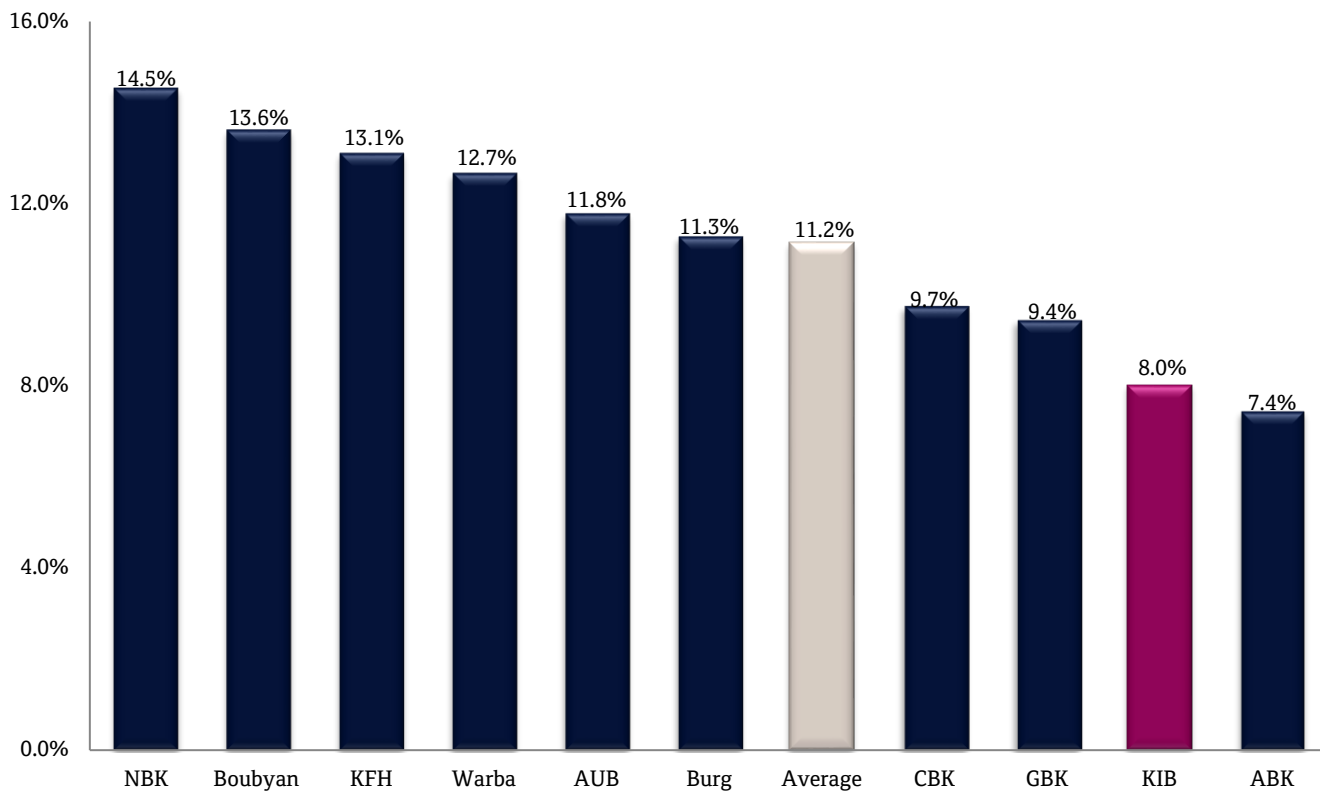
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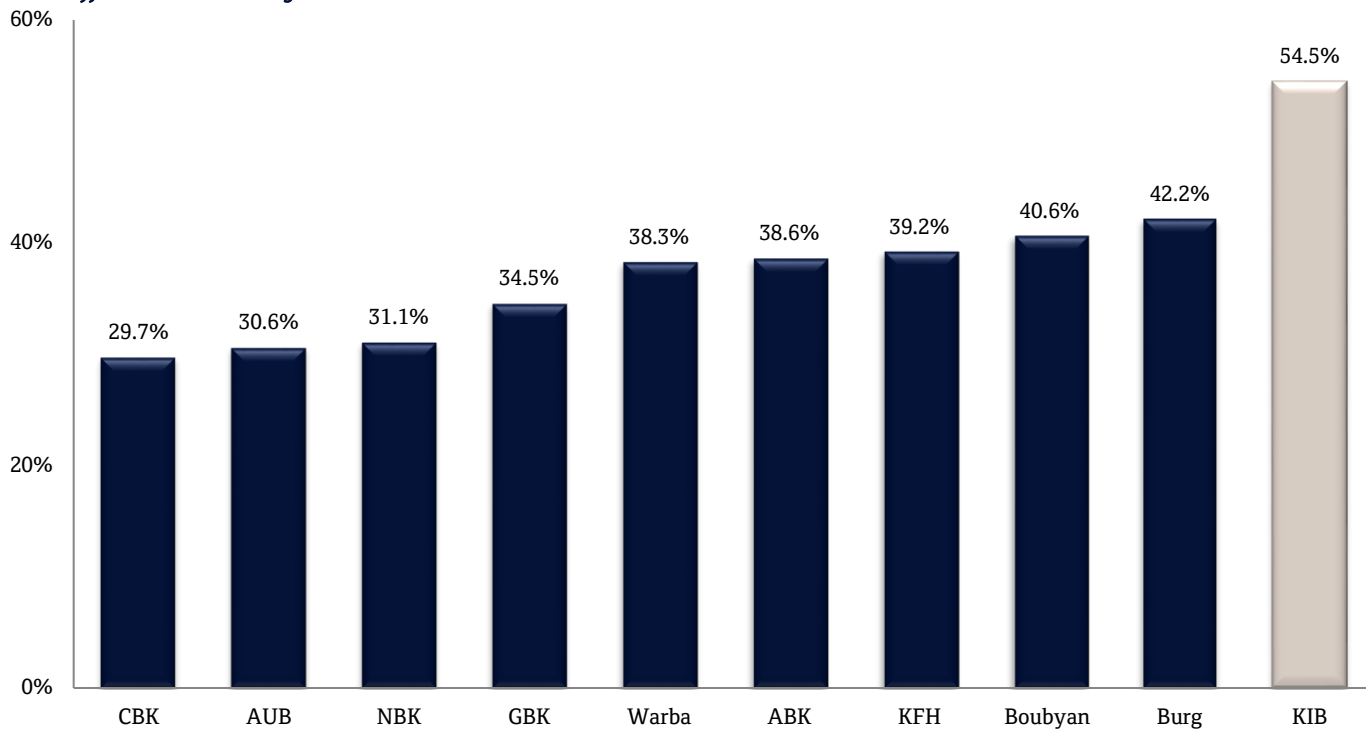
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We Expect KIB to Generate RoE of 7.8% in 2019e and 11.6% by 2023e from 8.0% in 2018



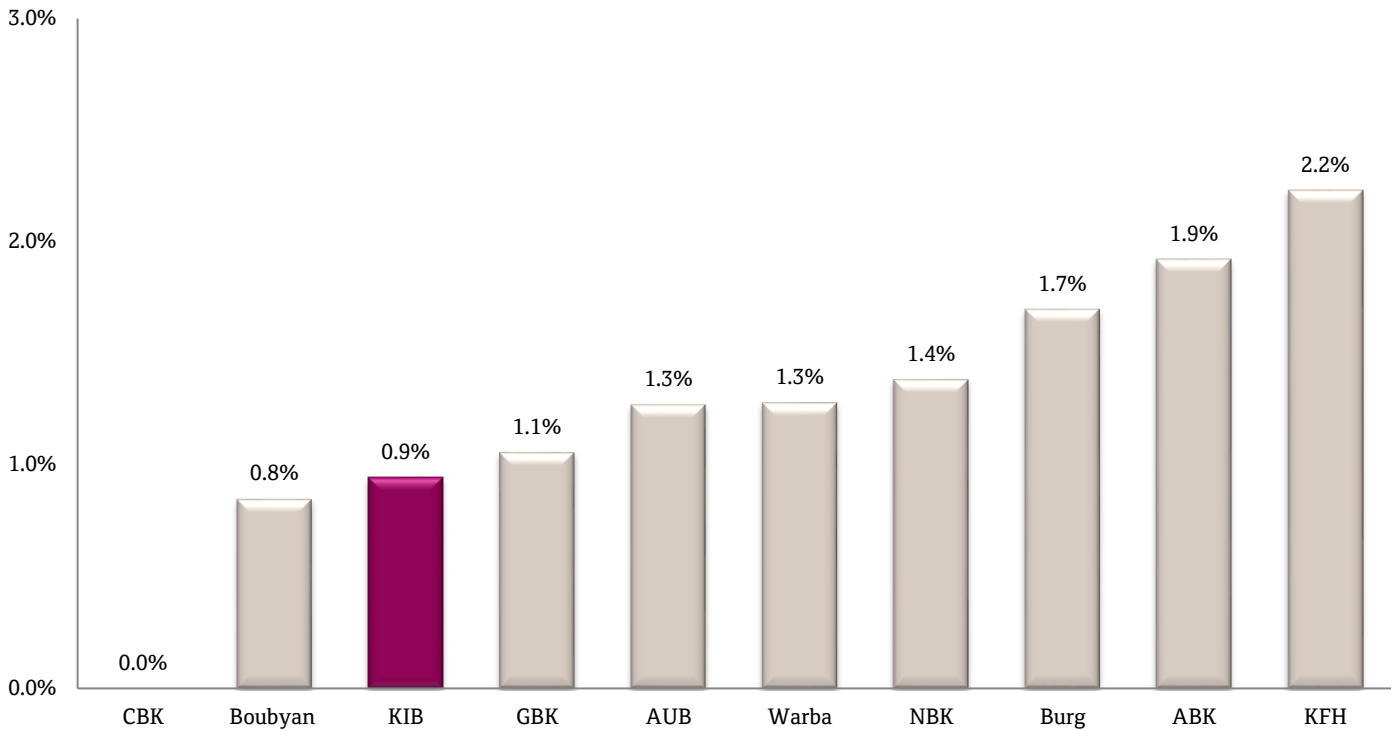
Source: Company data, QNB FS Research

Least Efficient Bank Among Peers



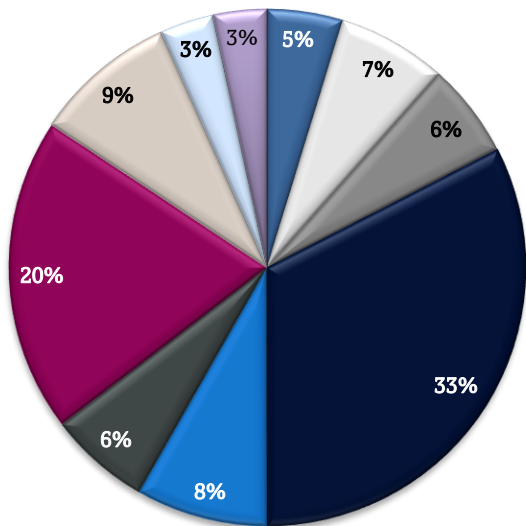
Source: Company data, QNB FS Research

KIB Enjoys a Strong Asset Quality Position



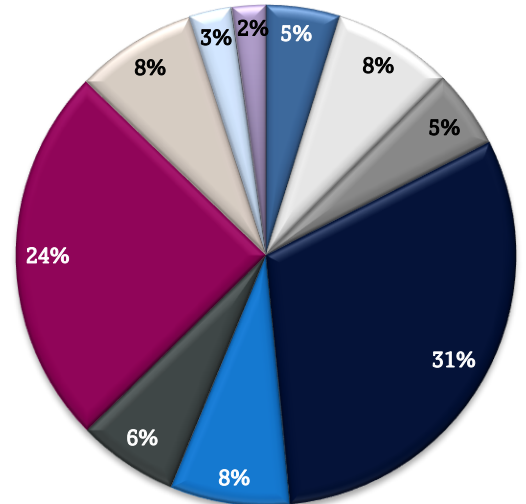
Source: Company data, QNB FS Research

~3% Market Share in Loans.....



■ CBK ■ Boubyan ■ AUB ■ NBK ■ GBK
 ■ ABK ■ KFH ■ Burg ■ KIB ■ Warba

..... And Deposits



■ CBK ■ Boubyan ■ AUB ■ NBK ■ GBK
 ■ ABK ■ KFH ■ Burg ■ KIB ■ Warba

Source: Company data, QNB FS Research

Valuation

We value KIB using the Residual Income Model (RI) based on a fundamental P/B:

We derive KIB's fair value by employing the RI valuation technique (*based on a fundamental P/B*), which is calculated based on the sum of its beginning book value, present value of interim residuals (net income minus equity charge) and the present value of the terminal value (we apply a fundamental P/B multiple based on the Gordon Growth Model to the ending book value at the end of our forecast horizon). We derive the P/B from the Gordon Growth Model: $P/B = (RoE-g)/(Ke-g)$. This model uses sustainable return on equity (RoE) based on the median over our forecast period, cost of equity (Ke) and expected long-term growth in earnings (g) to arrive at fundamental/justified P/B. **Based on this method we arrive at a fundamental P/B of 1.2x.**

We add Kuwait's 3 months average 10 year swaps rate of 1.09% to the 3 months average 10 year US government bond yield (2.75%) to arrive at a risk free rate of 3.8%. We factor in a beta of 1.0x. Finally, we add a local equity risk premium of 6.8% to arrive at a Ke of 10.68%.

Valuation Methodologies

Fundamental P/B		RI Based on Fundamental P/B	
Sustainable RoE (%)	11.7	Beginning BVPS (2019) (KWd)	281
Estimated Cost of Equity (%)	10.68	Present Value of Interim Residuals (KWd)	1
Terminal Growth Rate (%)	5.0	Present Value of Terminal Value (KWd)	37
Fundamental P/B	1.2x	Fundamental P/B	1.2x
		Intrinsic Value (KWd)	319
		Current Market Price (KWd)	272
		Upside/(Downside) Potential (%)	+17.4

Source: QNB FS Research

Forecast

	2018	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2026e	2027e	Terminal
Beginning BVPS	0.268	0.281	0.293	0.307	0.324	0.347	0.374	0.404	0.439	0.478	0.521
EPS Forecast	0.022	0.022	0.025	0.029	0.035	0.040	0.044	0.049	0.054	0.059	0.062
DPS Forecast	0.010	0.011	0.011	0.012	0.012	0.013	0.014	0.014	0.015	0.016	0.016
Adjustment	0.001	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Forecast BVPS	0.281	0.293	0.307	0.324	0.347	0.374	0.404	0.439	0.478	0.521	0.566
Equity Charge	0.029	0.030	0.031	0.033	0.035	0.037	0.040	0.043	0.047	0.051	0.056
Residual Income	-0.007	-0.008	-0.006	-0.004	0.000	0.003	0.004	0.006	0.007	0.008	0.006
Terminal Value (Based on Fundamental P/B)											0.099
Discounted Interim Residuals		-0.007	-0.005	-0.003	0.000	0.002	0.002	0.003	0.003	0.003	0.002
Discounted Terminal Value											0.037

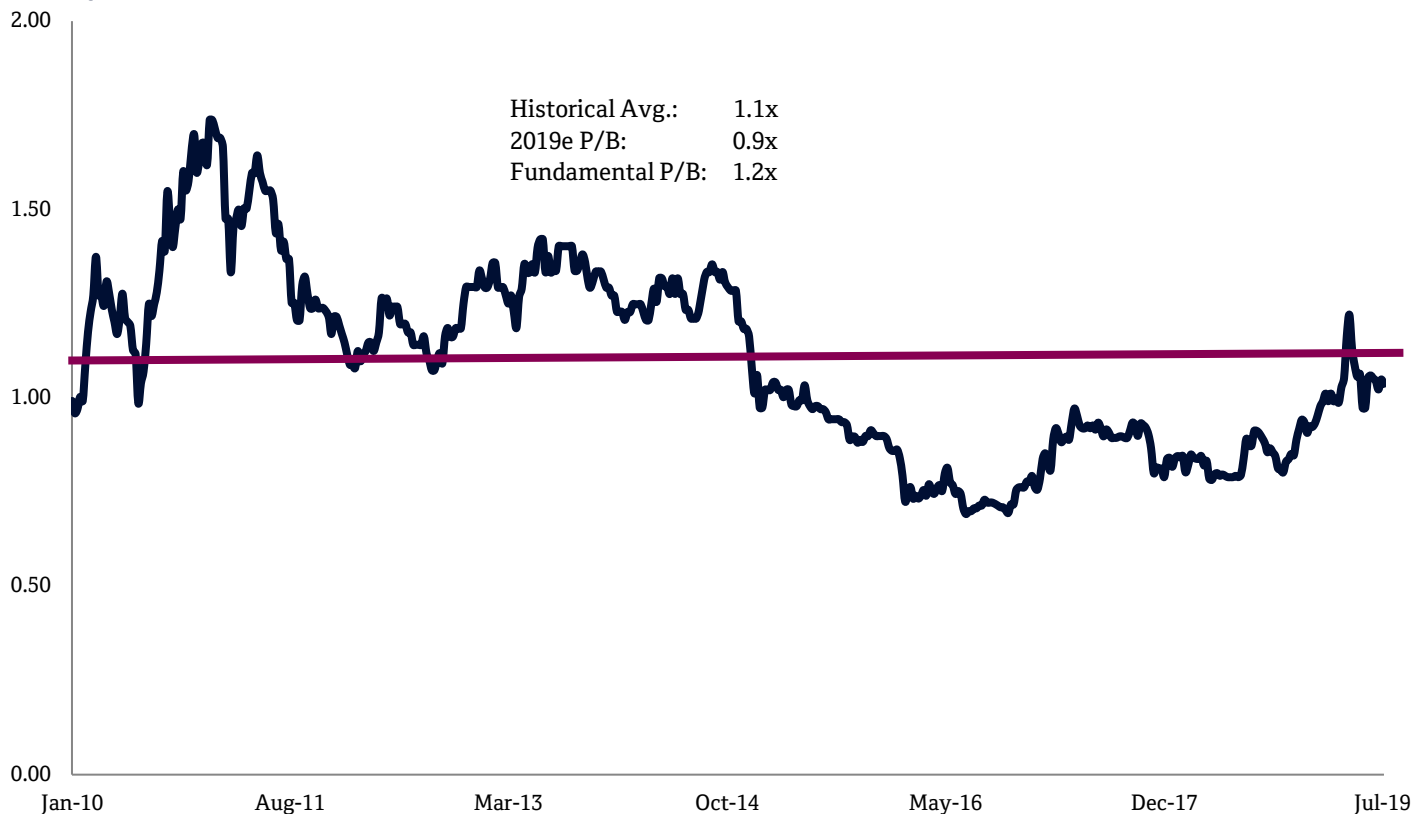
Source: QNB FS Research

Sensitivity Analysis

0.319	10.58%	10.63%	10.68%	10.73%	10.78%
4.00%	0.320	0.317	0.314	0.311	0.308
4.50%	0.323	0.320	0.316	0.313	0.310
5.00%	0.326	0.323	0.319	0.316	0.312
5.50%	0.331	0.327	0.323	0.319	0.315
6.00%	0.336	0.331	0.327	0.323	0.319

Source: QNB FS Research

Trading at a 14% Discount to its Historical P/B...



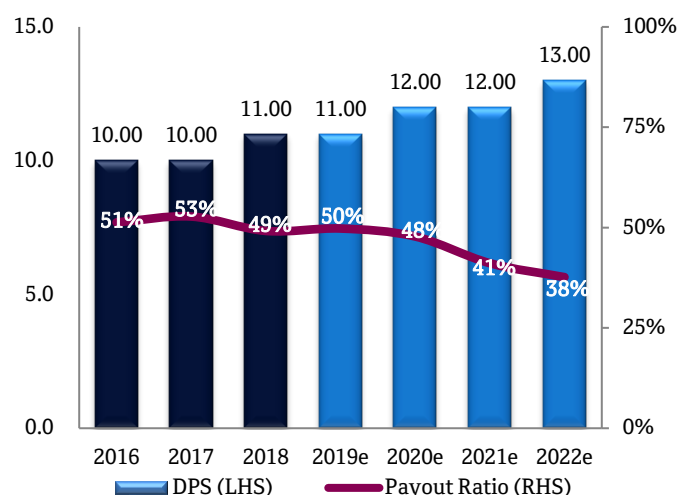
Source: Bloomberg, QNB FS Research

...And 24% Discount to its Historical P/E

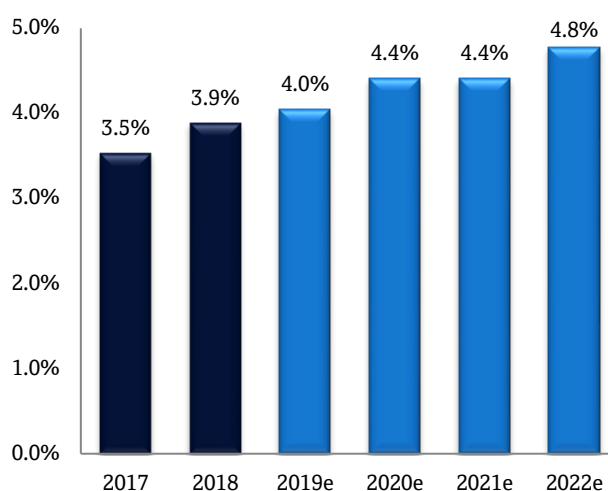


Source: Bloomberg, QNB FS Research

Regularly Pays Dividends



Healthy Yield



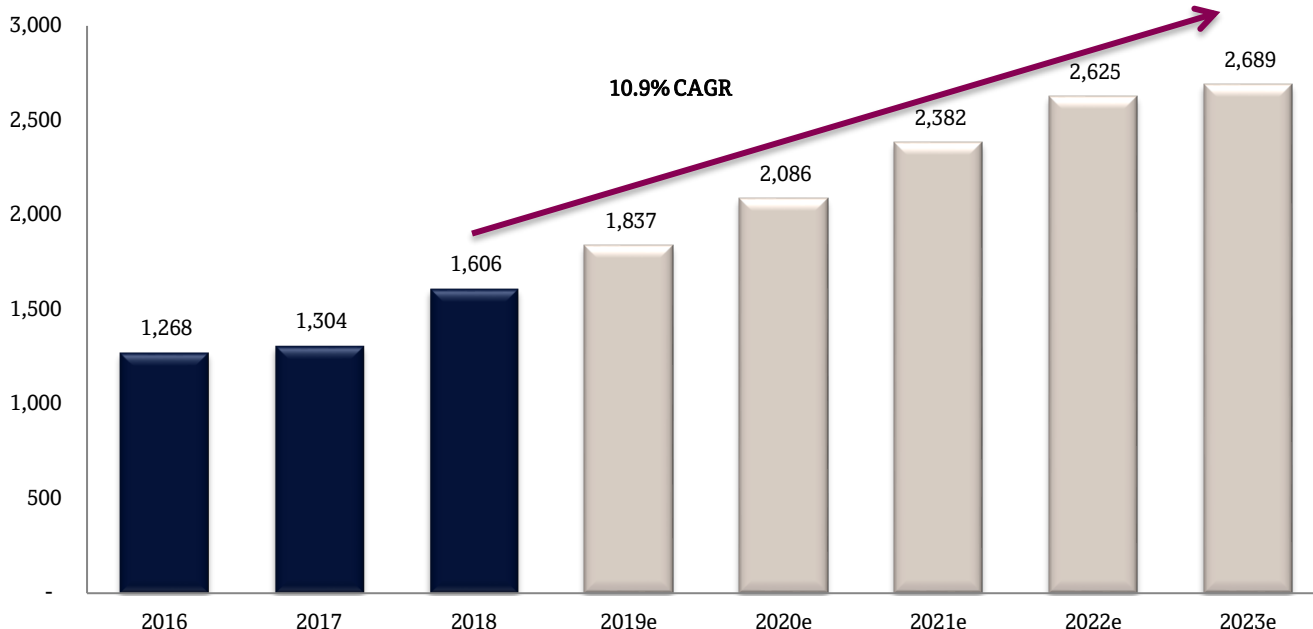
Source: Company data, QNB FS Research

Key Forecasts

Loan Portfolio

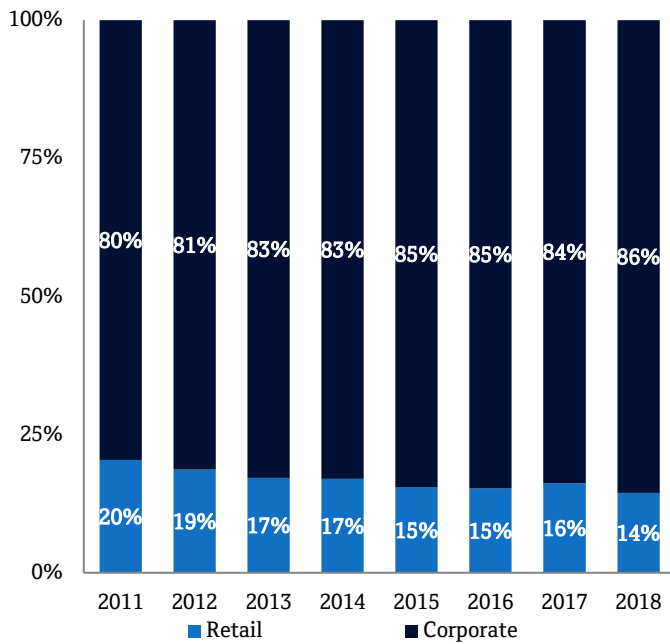
KIB is a small-sized corporate focused bank and has a 3% market share in loans and deposits; we pencil in a loan book CAGR (2018-23e) of 10.9%. KIB has been de-risking its loan book since 2010 when the financial crisis adversely effected the bank. Consequently, the bank’s legacy real estate portfolio was impaired. As such the bank shifted its focus to the government backed oil & gas sector along with other government-related projects, prime contractors and aviation leasing. Moreover, KIB has been actively participating in syndicated loans taking place in the GCC. When it comes to the real estate segment, the bank finances cash flow generating projects which it deems to be safe.

Loans (KWD mn) to Exhibit 10.9% CAGR vs. 10.4% (2012-18)



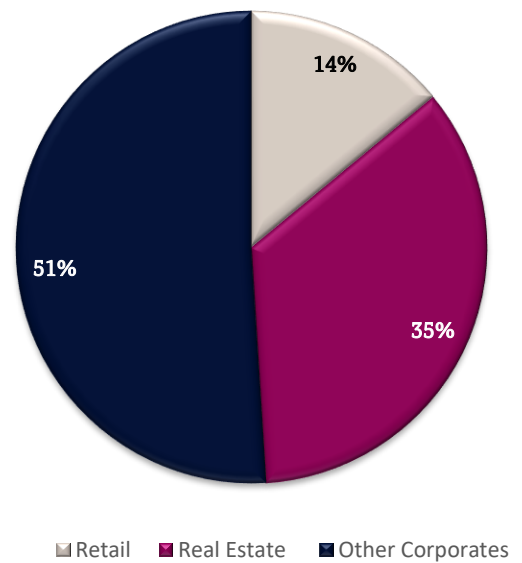
Source: Company data, QNB FS Research

Corporate Focused



Source: Company data, QNB FS Research

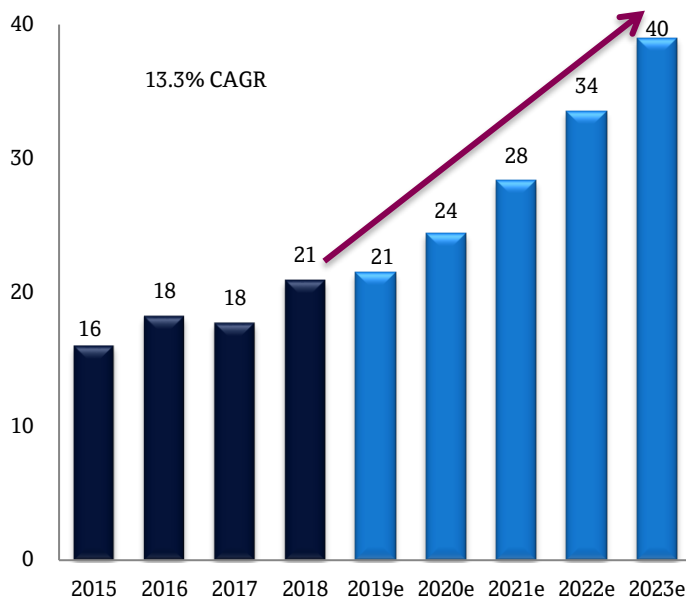
Real Estate Remains a Large Chunk of Loans



Operating Performance

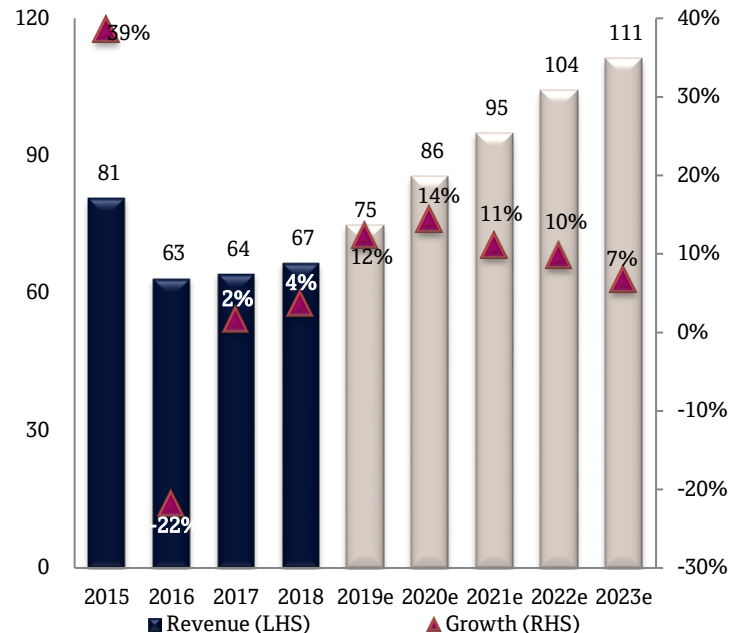
We pencil in a bottom-line CAGR of 13.3% in 2018-2023e vs. +9.6% (2013-2018). The growth in net income is expected to be driven by net interest income (11.7% 5-year CAGR), non-funded income and flat credit provisions which we model to decrease by 0.9% vs. +4.4% (past 5 years). *Having said this, there could be further upside to our estimates if KIB reduces provisions and books recoveries ahead of our model expectations.* Like all Kuwaiti banks, general/precautionary provisions (imposed by the Central Bank) are much greater than specific provisions. As such, hefty reversals can unlock value, boosting profitability (RoE should materially increase).

Net Profit (KWD mn)

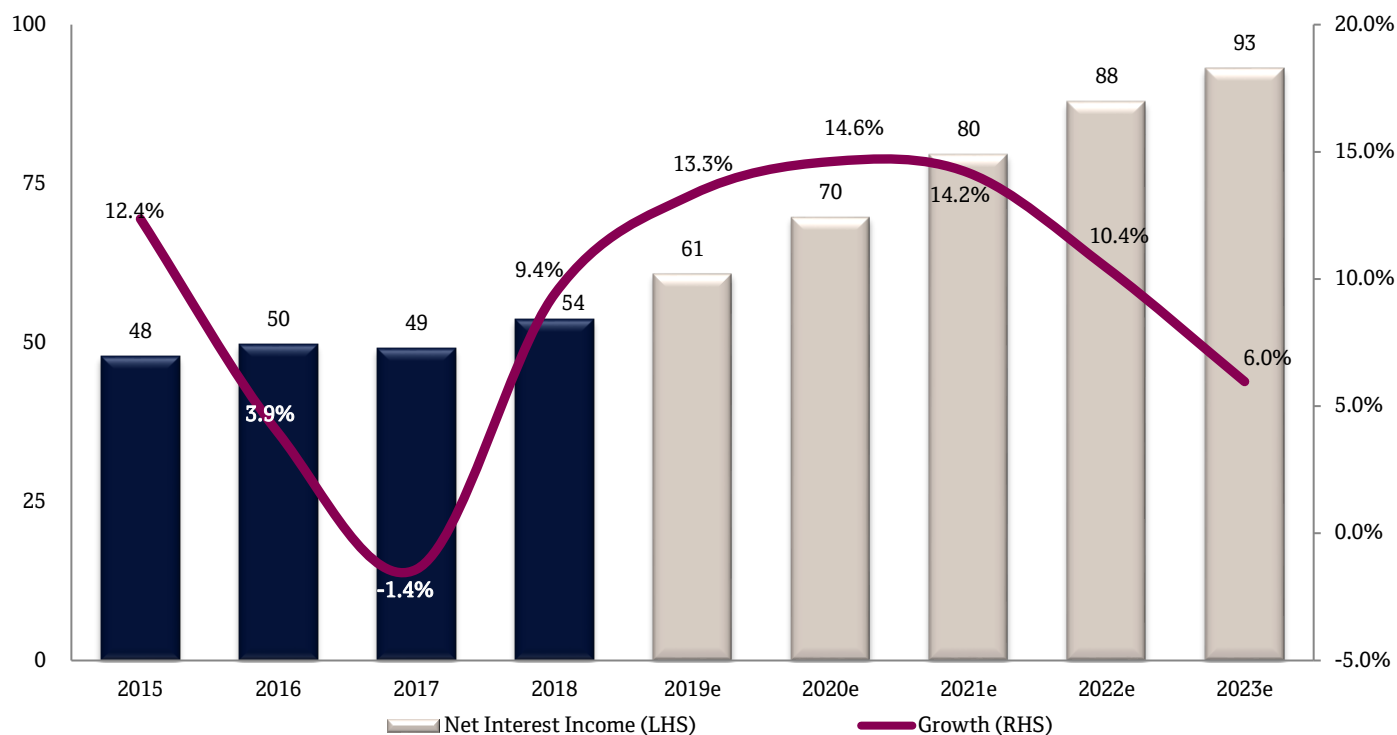


Source: Company data, QNB FS Research

Revenue (KWD mn)



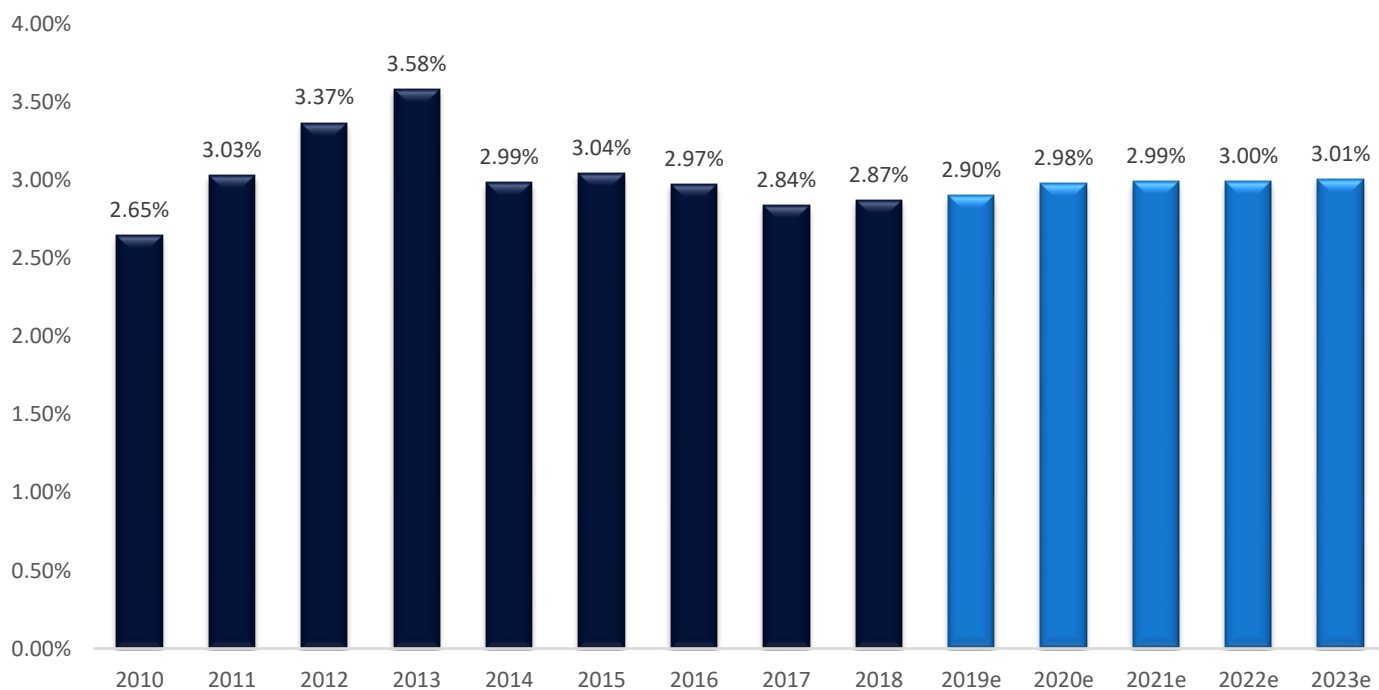
Net Interest Income (KWD mn)



Source: Company data, QNB FS Research

Growth in net interest income to pick up. We forecast NII to grow by a CAGR of 11.7% (2018-2023e) vs. 4.0% (2013-2018) as margins begin to expand.

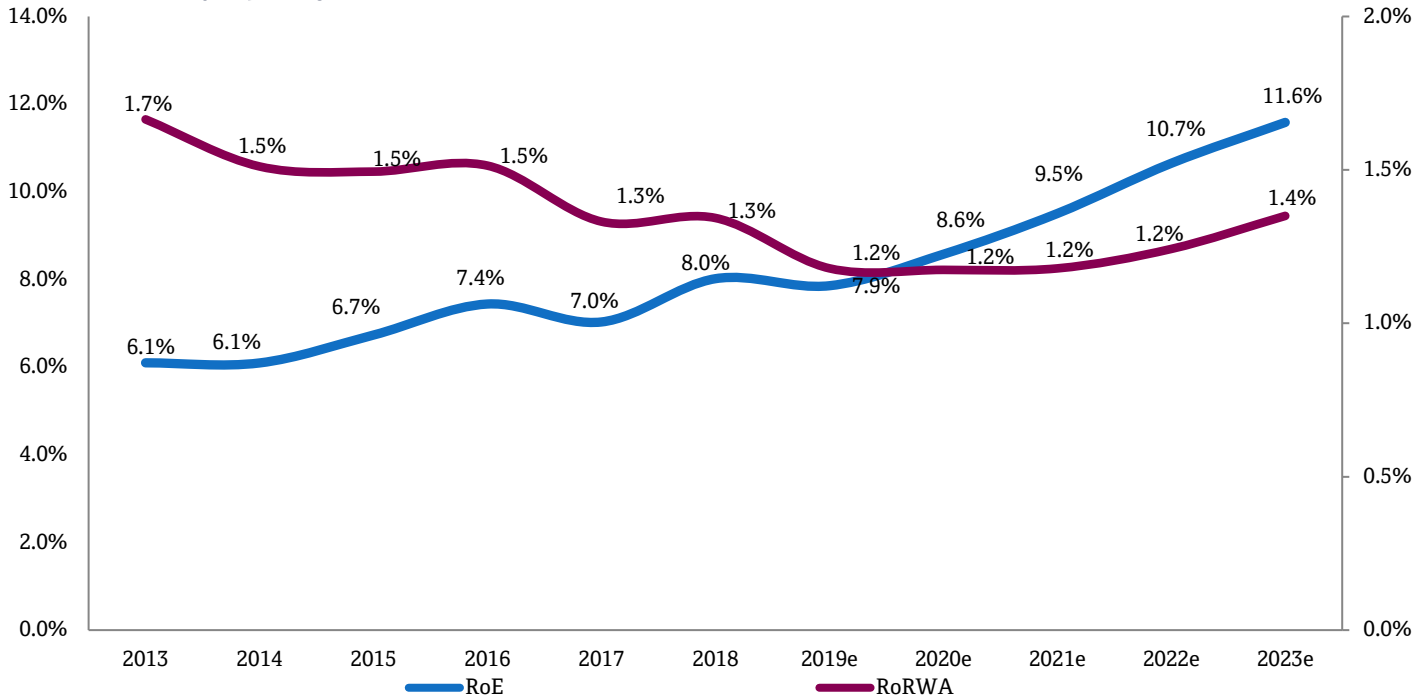
NIMs to Steadily Increase



Source: Company data, QNB FS Research

We do not expect NIMs to grow aggressively. We expect only modest increases in the NIM due to the fact that KIB is geared towards low-margin corporate banking and government-backed projects.

RoE is Continuously Improving

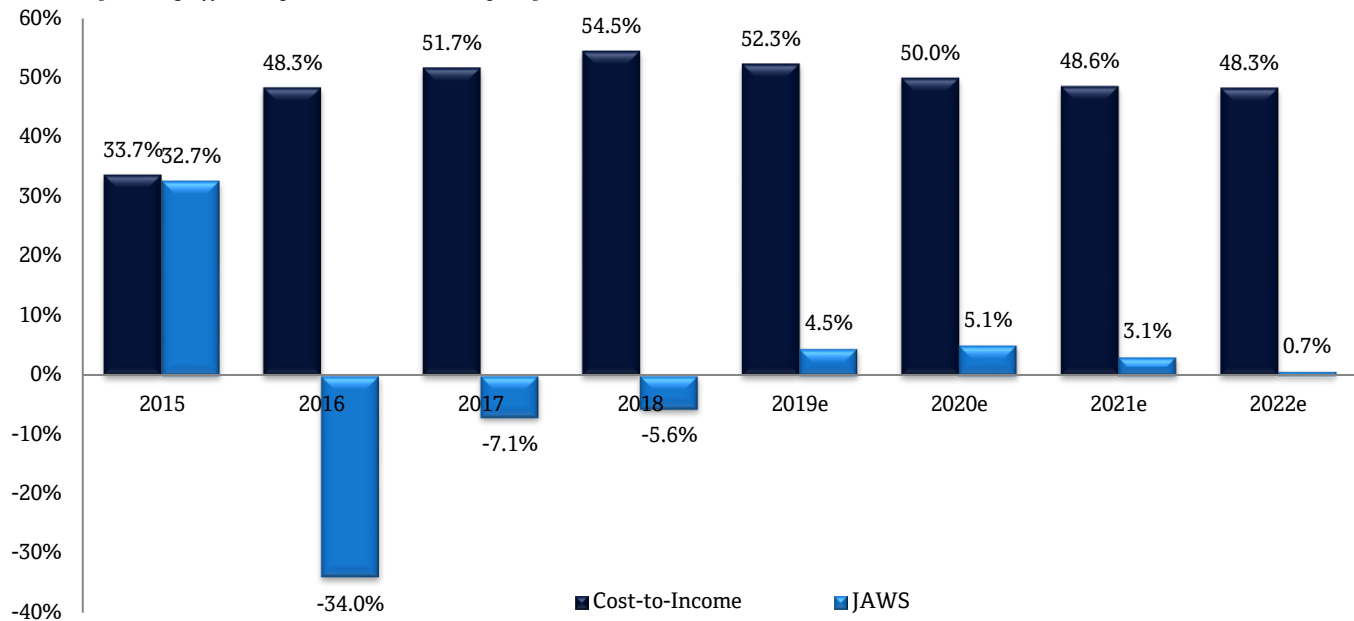


Source: Company data, QNB FS Research

RoE improvement dependent on CoR. RoE is steadily increasing based on our estimates. Reversals of reserves for loan losses and recoveries from net write-offs can boost RoE significantly beyond our estimates.

Efficiency

KIB's Operating Efficiency Needs to Materially Improve

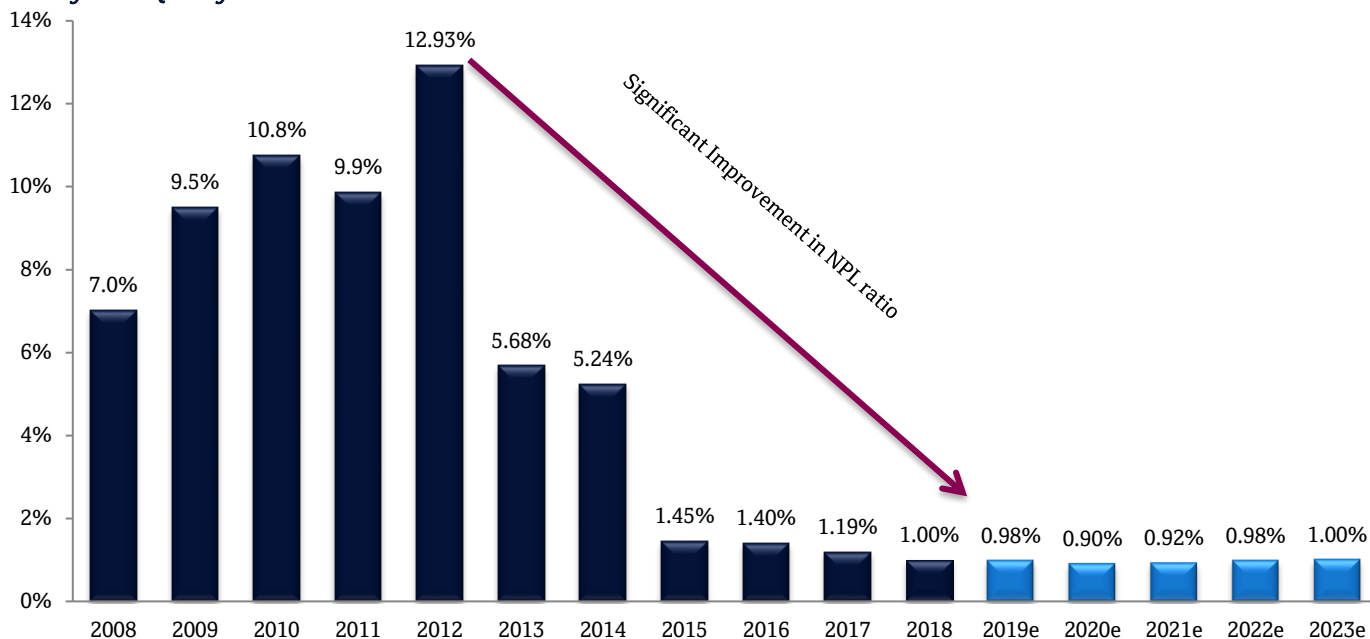


Source: Company data, QNB FS Research

Least efficient bank among peers – KIB's C/I ratio is at elevated levels. We expect the efficiency ratio to steadily but not drastically decline in our forecast horizon. The reason that we do not anticipate a drop to the mid-30%'s as small banks tend to have high C/I ratios vs. large/mature banks. It should be noted that KIB has not been successful in generating positive JAWS as growth in opex has outpaced growth in revenue. However, we expect some positive JAWS going forward as the bank ramps up growth.

Asset Quality

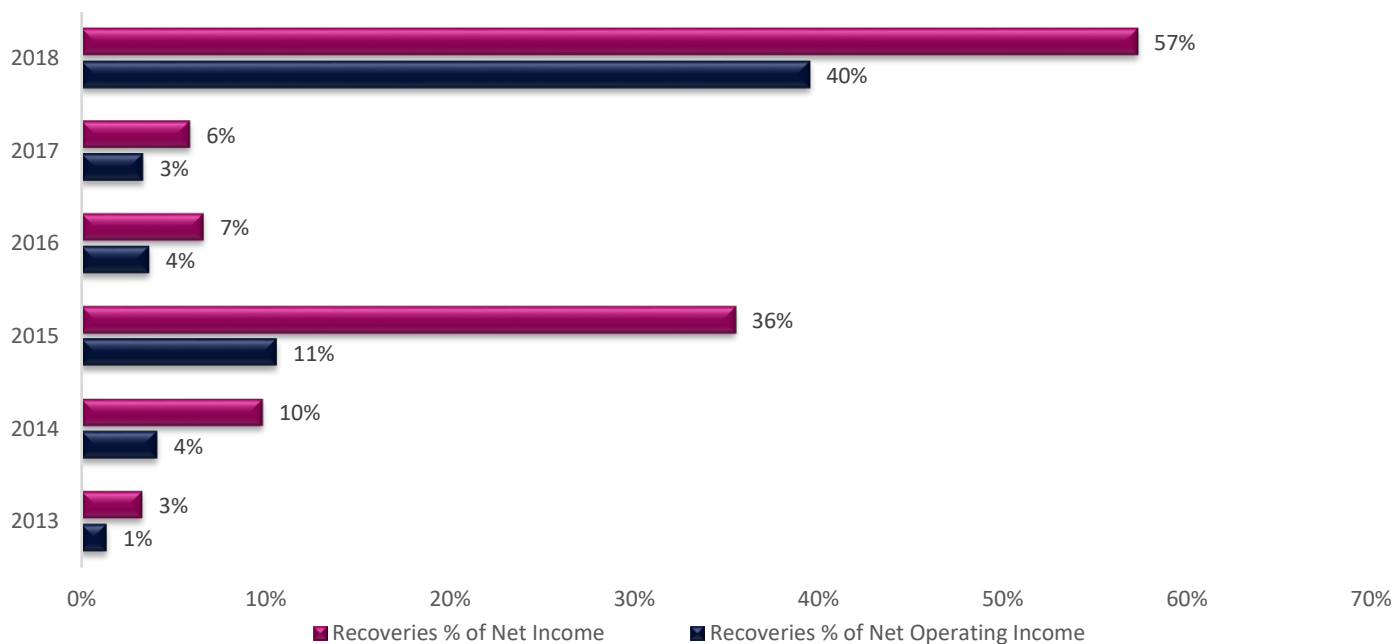
Healthy Asset Quality



Source: Company data, QNB FS Research

KIB adopted a prudent/conservative risk management approach. KIB has cleaned up its books since 2012 when the NPL ratio reached a high of 12.9% to 1.00% in 2018. The jump in NPLs took place during the 2008-10 financial crisis when investment companies and real estate firms defaulted on their debt (these were real estate legacy NPLs before KIB's transition from Kuwait Real Estate Bank). The NPL ratio declined through write-offs and de-risking the loan book. It is worth noting that KIB has been recovering a decent portion of the write-offs (further recoveries would be a positive surprise for earnings).

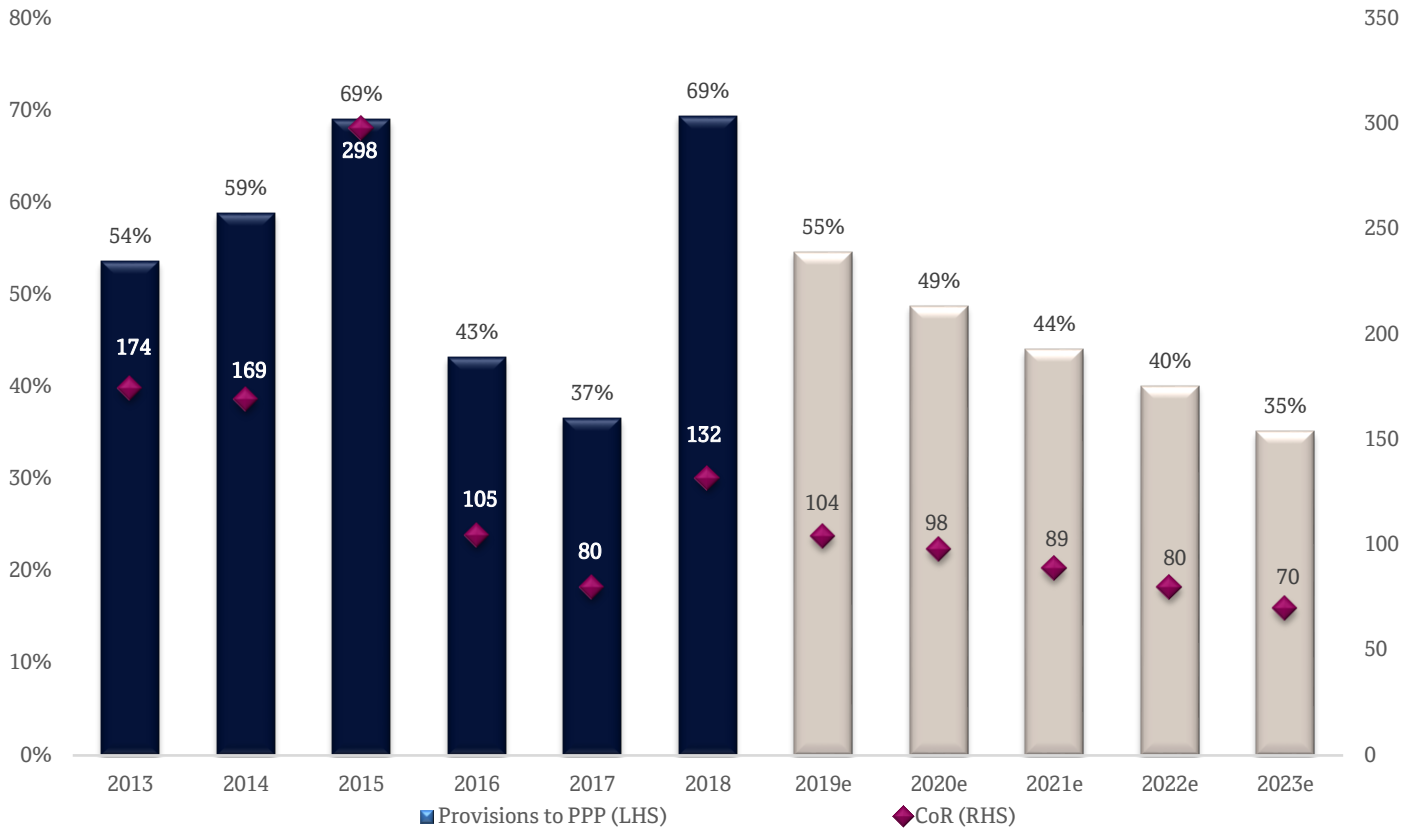
Recoveries Key to Bottom-Line Growth



Source: Company data, QNB FS Research

Recoveries of loans written-off aided bottom-line growth. Recoveries have practically contributed ~20% to KIB's profitability. More recoveries are expected and would be a positive surprise for earnings. Since 2011, the bank has written off KWD 16.7mn loans on an average per year (1.5% of average loans 2011-2018) vs. average recoveries of KWD3.3mn (which means they have recovered ~20% of loans written off).

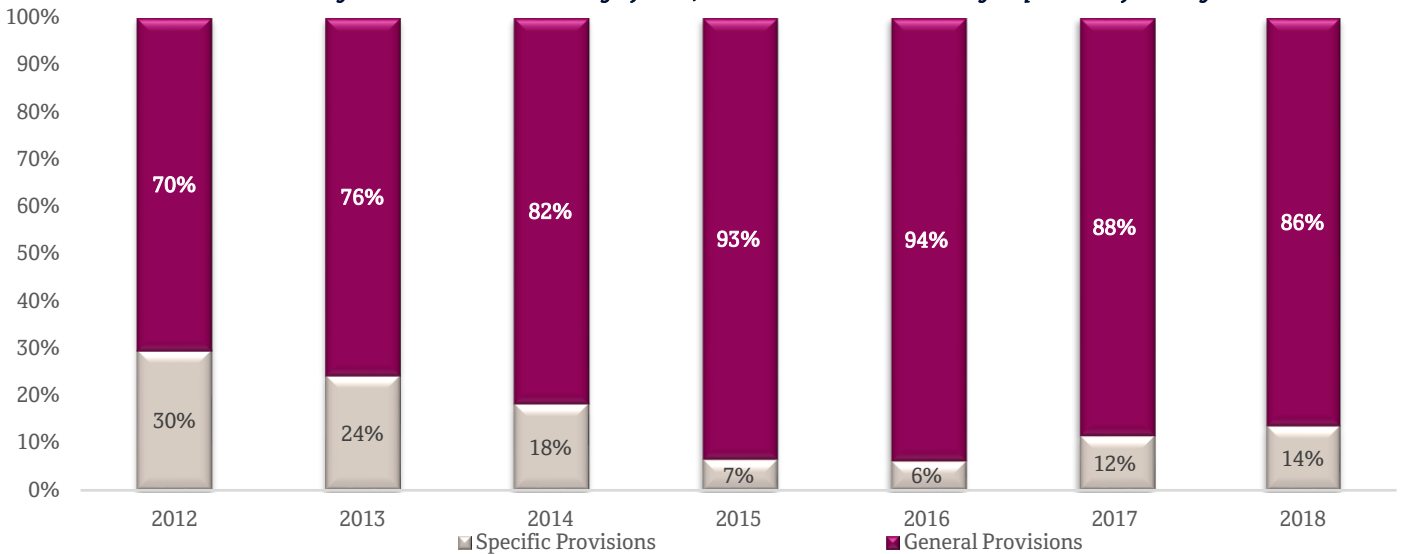
CoR Significantly Improved but Still Remains on the High Side



Source: Company data, QNB FS Research

Cost of risk needs to significantly improve like all banks in Kuwait. KIB’s high cost of risk is mainly driven from the Central Bank of Kuwait (CBK) imposing excessive precautionary provisions on banks. KIB’s precautionary & general provisions contributed 94% to total credit provisions in 2016, 88% in 2017 and 86% in 2018. A reversal of these provisions or applying them to ECLs as a one-time impairment charge would unlock great value and would materially enhance profitability metrics (RoE, RoA, Net Profit Margin etc.). As per IFRS 9, KIB’s ECLs amount to KWD 44.25mn vs. total provisions of KWD 51.0mn, generating excess provisions of KWD 6.78mn

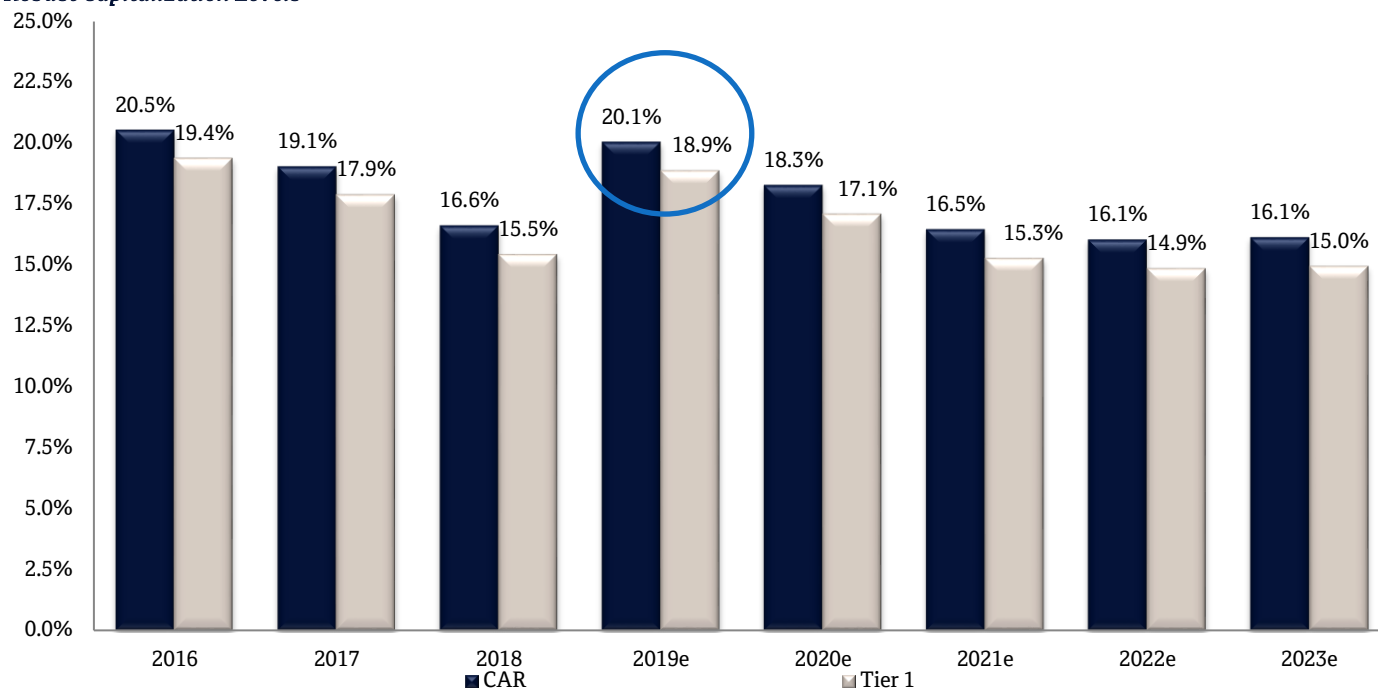
General Provisions/Precautionary to Total Provisions is Significant; Reversals Would Materially Improve Profitability Metrics



Source: Company data, QNB FS Research

Capitalization

Robust Capitalization Levels



Source: Company data, QNB FS Research

\$300mn ADT1 Sukuk bolsters Tier-1 and supports growth. KIB's assets grew by a CAGR (2012-18) of 9.6%, while the Tier-1 ratio dropped from 22.5% to 15.5%. The bank aims to grow further and as such issued ADT1 Sukuk of \$300mn. Hence, KIB's Tier-1 ratio is likely to jump from 15.5% in 2018 to 18.9% (2019e). Given the ADT1 issuance, we expect KIB's bottom-line to grow at a CAGR (2018-2023e) of 13.3% while maintaining an average Tier-1 ratio of 16.5%. Moreover, with this trend we expect the bank to generate a RoE of 10.7% and 11.6% by 2022 & 2023, respectively. It is worth noting that RoE could have been higher, but interest expense on the ADT1 eats away from the bottom-line by ~15%.

Company Description

Established in 1973 as Kuwait Real Estate Bank, the bank transformed in July 2007 to Kuwait International Bank (Shari'ah compliant). KIB is a small Kuwait-focused bank and has a ~3% market share in loans and deposits. KIB is a universal bank offering services to corporates and retail customers, private banking, treasury services and real estate management. The bank operates a branch network of 24 branches and 94 ATMS.

Major Shareholders

Shareholders	Investor Type	Country	Share (%)
Bukhamseen Group Holding & its subsidiaries & associates & parties allied Co	Private	Kuwait	35.87
The Public Institution for Social Security (PIFSS)	Government	Kuwait	7.50

Source: Boursa Kuwait

Detailed Financial Statements

Ratios	2016	2017	2018	2019e	2020e	2021e	2022e
Profitability (%)							
RoE	7.3	6.9	7.8	7.7	8.4	9.2	10.3
RoAA	1.0	0.9	1.0	1.1	1.2	1.2	1.2
RoRWA	1.5	1.3	1.3	1.2	1.2	1.2	1.2
NIM (% of IEAs)	2.97	2.84	2.87	2.90	2.98	2.99	3.00
NIM (% of RWAs)	4.14	3.69	3.45	3.34	3.36	3.31	3.26
NIM (% of AAs)	2.74	2.61	2.63	2.67	2.75	2.78	2.78
Spread	2.2	1.9	1.8	1.6	1.4	1.2	1.1
Efficiency (%)							
Cost-to-Income (Headline)	48.3	51.7	54.5	52.3	50.0	48.6	48.3
Cost-to-Income (Core)	49.4	53.9	54.8	53.3	51.4	49.4	49.1
Liquidity (%)							
LDR	112.8	108.4	121.8	123.3	122.8	123.0	121.1
Loans/Assets	68.7	68.1	74.0	76.8	78.1	78.2	80.4
Cash & Interbank Loans-to-Total Assets	22.3	22.0	16.5	14.2	13.5	14.2	11.4
Deposits to Assets	60.9	62.8	60.8	62.3	63.6	63.6	66.4
Wholesale Funding to Loans	33.0	30.2	32.2	25.2	24.7	26.3	21.4
IEAs to IBLs	168.5	159.5	151.5	163.9	166.5	162.1	163.8
Asset Quality (%)							
NPL Ratio	1.40	1.19	1.00	0.98	0.90	0.92	0.98
NPLs to Shareholders' Equity	7.3	6.1	6.1	6.9	6.8	7.5	8.2
NPL to Tier 1 Capital	7.6	6.4	6.3	7.1	7.1	7.8	8.5
Coverage Ratio	268.6	282.1	308.0	309.2	350.6	350.0	340.6
ALL/Average Loans	0.2	0.4	0.5	0.7	0.9	1.0	1.2
Cost of Risk (bps)	105	80	132	104	98	89	80
Capitalization (%)							
Tier 1 Ratio	19.4	17.9	15.5	18.9	17.1	15.3	14.9
CAR	20.5	19.1	16.6	20.1	18.3	16.5	16.1
Tier 1 Capital to Assets	13.2	13.1	12.1	15.3	14.2	13.0	12.8
Tier 1 Capital to Loans	19.1	19.3	16.4	19.9	18.2	16.6	15.9
Tier 1 Capital to Deposits	21.6	20.9	20.0	24.5	22.3	20.4	19.3
Growth (%)							
Net Interest Income	3.9	-1.4	9.4	13.3	14.6	14.2	10.4
Non-Interest Income	-59.1	13.2	-14.7	7.9	13.2	-2.6	6.2
Total Revenue	-21.7	1.7	3.7	12.3	14.3	11.1	9.8
Opex	12.2	8.8	9.3	7.7	9.2	7.9	9.1
Net Operating Income	-39.0	-4.9	-2.3	17.7	20.0	14.2	10.4
Net Income (Headline/Reported)	13.8	-2.8	18.0	15.0	22.8	13.4	15.5
Net Income (Attributable)	13.8	-2.8	18.0	2.7	13.6	16.2	18.3
Loans	8.1	2.8	23.1	14.4	13.5	14.2	10.2
Deposits	10.5	7.0	9.6	13.0	14.0	14.0	12.0
Assets	3.1	3.8	13.2	10.2	11.8	14.0	7.2
RWAs	8.7	12.3	21.2	13.6	14.5	16.7	8.5

Source: Company data, QNB FS Research

Income Statement (In KWD mn)	2016	2017	2018	2019e	2020e	2021e	2022e
Net Interest Income	50	49	54	61	70	80	88
Fees & Commissions	9	9	10	10	10	11	11
FX Income	1	1	1	1	1	1	1
Other Income	4	5	2	3	5	4	4
Non-Interest Income	13	15	13	14	16	15	16
Total Revenue	63	64	67	75	86	95	104
Operating Expenses	(31)	(33)	(36)	(39)	(43)	(46)	(50)
Net Operating Income	33	31	30	36	43	49	54
Net Provisions & Impairments	(14)	(12)	(8)	(10)	(12)	(14)	(13)
Net Profit Before Tax	19	19	22	25	31	35	41
Tax	(1)	(1)	(1)	(1)	(1)	(2)	(2)
Net Profit Before Minority Interest	18	18	21	24	30	34	39
Minority Interest	(0)	(0)	(0)	(0)	(0)	(0)	(0)
Net Profit (Headline/Reported)	18	18	21	24	30	33	39
Interest on ADT1 Sukuk				(3)	(5)	(5)	(5)
Net Profit (Attributable to Shareholders)	18	18	21	21	24	28	34

Source: Company data, QNB FS Research

Balance Sheet (In KWD mn)	2016	2017	2018	2019e	2020e	2021e	2022e
Cash & Balances with Central Bank	18	19	42	45	48	52	56
Interbank Loans	393	403	316	294	313	381	315
Net Investments	86	84	106	112	119	120	130
Net Loans	1,268	1,304	1,606	1,837	2,086	2,382	2,625
Other Assets	55	79	71	71	73	74	99
Net PP&E	26	26	29	31	34	36	40
Total Assets	1,846	1,916	2,169	2,391	2,672	3,045	3,266
Liabilities							
Interbank Deposits	418	394	518	462	516	628	561
Customer Deposits	1,125	1,203	1,319	1,490	1,699	1,936	2,169
Other Liabilities	48	54	56	60	65	72	104
Additional Tier-1 Perpetual Sukuk				91	91	91	91
Total Liabilities	1,591	1,652	1,892	2,103	2,370	2,727	2,925
Minority Interest	3	3	3	4	4	4	4
Shareholders' Equity	252	261	273	284	298	315	337
Total Liabilities & Shareholders' Equity	1,846	1,916	2,169	2,391	2,672	3,045	3,266

Source: Company data, QNB FS 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

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