

Al Khalij Commercial Bank (KCBK)

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	QR1.600	Target Price	QR1.554
Implied Upside	(2.9%)	Old Target Price	QR1.400

KCBK Proves to be Resilient; Raising PT to QR1.554

KCBK has proven to be resilient so far in 2020 and its 1H2020 bottom-line has increased by 2.6% despite a spike in provisions. As such, we raise our 2019-24e earnings CAGR from 9.3% to 11.2% notwithstanding further ramifications from the COVID-19 pandemic. We also have better visibility on RoE generation and hence raise our PT from QR1.400 to QR1.554 but maintain our Market Perform rating. On July 1, Masraf Al Rayan (MARK) and Al Khalij Commercial Bank (KCBK) announced a potential merger between the two banks. Following the announcement, KCBK's shares rallied over several sessions becoming the best performing banking stock vs. its peers. The stock is up 22% YTD, while most of its peers are in the red. The name now trades at a 0.9x P/B (vs. 0.7x pre-merger announcement) and a 9.6x P/E based on our 2020 estimates, which we now think is justified. Moreover, KCBK trades at a PEG of 0.9x, which indicates that it is hovering around its fair value.

Highlights

- **Given KCBK's asset/liability interest rate gap, we expect further margin expansion beyond our previous positive estimates.** 60% of the bank's assets are repriceable within 1-year vs. 74% of liabilities to total assets; this should lead to some margin expansion in a low interest rate environment. Hence, we expect NIMs to increase by 19bps from 1.98% in 2019 to 2.17% in 2020 and expand a further 7 bps in 2021. Net Interest Income expanded by 20.5% YoY in 1H2020 to QR575.5mn on the back of a large drop in CoFs. Thus, NIMs moved up by ~18bps YoY to 2.25%.
- **Management continues to operate efficiently.** Core opex (excluding QR20mn in goodwill impairment) in 1H2020 dropped by 4.1% YoY. Thus, KCBK generated a cost-to-income ratio of 23.2% vs. 27.2% in 1H2019. The bank's C/I has significantly improved from 2014's 42.0%. We foresee the bank remaining cost-efficient for the foreseeable future, penciling in C/I ratios of 25.8% (2020) and 23.6% (2021). Moreover, based on our estimates, KCBK is expected to continue generating positive JAWS.
- **Net loans are estimated to experience low-single-digit growth in 2020; loans were on the decline in the previous quarters as management shed non-core low yielding assets, targeting more lucrative deals.** In 2Q2020, net loans expanded by 4.5% YTD to QR32.2bn, while deposits remained flattish at QR29.2bn. Moreover, KCBK's LDR (based on stable sources of funds) elevated to 100% vs. 88% in FY2019. Nevertheless, we expect the LDR to drop to 92% by year end.
- **Asset quality remained healthy in light of current conditions.** NPLs increased by 2.6% YTD to QR621.9mn. On the other hand, the NPL ratio marginally improved to 1.83% vs. 1.86% in FY2019. Coverage of Stage 3 loans remained flat at 79% vs. 80% in FY2019 (80% in 1Q2020). We expect the coverage ratio to be adequately maintained as management exercises prudent risk control.
- **Provisions for credit losses increased as a precautionary measure against COVID-19.** Provisions increased by 53.5% YoY to QR107.8mn in 1H2020. Moreover, CoR jumped from ~46bps in 1H2019 (annualized) to ~63bps in 1H2020 (59bps in FY2019). We expect CoR of 61 bps in 2020 given the current environment but estimate lower future provisions leading to CoR of 54 bps and 50 bps in FY2021 and 2022, respectively.
- **Tier-1 to remain robust as the bank continues on optimizing RWAs; management has no plans to reduce capitalization levels.** The bank's CET1 and Tier-1 ratios rested at 14.8% and 17.4%, respectively. We expect capitalization to remain on the high side in 2020 and the coming years. KCBK's strong capitalization levels could help it absorb any further unexpected shocks arising from the coronavirus.

Catalysts

- **Visible progress in management's strategy:** 1) Successful merger with MARK, 2) an expansion of attributable RoE beyond 12% (2020e and 2021e RoE: 10.2% and 12.2%, respectively) and 3) improvement in the liquidity of the stock.

Recommendation, Valuation and Risks

- **Recommendation and valuation: We maintain our Market Perform rating but raise target price from QR1.400 to QR1.554.** KCBK trades at P/TB and P/E of 0.9x and 9.6x on our 2020 estimates, respectively.
- **Risks:** 1) Oil price shock and 2) Global recession driven by the coronavirus pandemic.

Key Financial Data and Estimates

	2019	2020e	2021e	2022e
EPS (QR)	0.160	0.167	0.212	0.242
Growth (%)	6.9	4.3	27.0	14.3
P/E (x)	10.0	9.6	7.6	6.6
TBVPS (QR)	1.63	1.73	1.87	2.04
P/TB (x)	1.0	0.9	0.9	0.8
RoE (%)	10.6	10.2	12.2	13.0
DPS (QR)	0.075	0.075	0.075	0.075
Dividend Yield (%)	4.7	4.7	4.7	4.7

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

Key Data

Current Market Price (QR)	1.600
Dividend Yield (%)	4.7
Bloomberg Ticker	KCBK QD
ADR/GDR Ticker	N/A
Reuters Ticker	KCBK.QA
ISIN	QA000A0M6MD5
Sector*	Banks & Fin. Svcs.
52wk High/52wk Low (QR)	1.654/1.091
3-m Average Volume (mn)	3.14
Mkt. Cap. (\$ bn/QR bn)	1.6/5.8
Shares Outstanding (bn)	3.60
FO Limit* (%)	49.0
Current FO* (%)	9.1
1-Year Total Return (%)	44.3
Fiscal Year End	December 31

Source: Bloomberg (as of August 13, 2020), *Qatar Exchange (as of August 12, 2020); Note: FO is foreign ownership

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Change in Estimates

In QR mn	2020e			2021e			2022e		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Net Interest Income	1,030	1,124	9.1%	1,111	1,240	11.7%	1,204	1,362	13.1%
Non-Interest Income	193	160	-17.2%	200	190	-5.0%	213	211	-1.1%
Total Revenue	1,223	1,284	5.0%	1,311	1,431	9.1%	1,417	1,572	11.0%
Opex	335	351	4.6%	344	338	-1.9%	364	356	-2.3%
Net Operating Income	888	933	5.1%	967	1,093	13.0%	1,053	1,217	15.6%
Net Income (Reported)	677	672	-0.8%	745	838	12.5%	823	955	16.1%
Net Income (Attributable)	605	600	-0.8%	672	762	13.4%	742	871	17.4%

Source: QNB FS Research

Detailed Financial Statements

Income Statement (In QR mn)	2017	2018	2019	2020e	2021e	2022e	2023e
Net Interest Income	984	915	980	1,124	1,240	1,362	1,466
Fees & Commissions	182	190	177	150	162	169	155
FX Income	39	38	18	6	17	27	32
Other Income	9	0	4	4	11	15	12
Non-Interest Income	231	228	198	160	190	211	199
Total Revenue	1,215	1,143	1,178	1,284	1,431	1,572	1,665
Operating Expenses	(335)	(329)	(329)	(351)	(338)	(356)	(375)
Net Operating Income	880	814	849	933	1,093	1,217	1,289
Net Provisions & Impairments	(319)	(190)	(176)	(234)	(221)	(223)	(227)
Net Profit Before Taxes	562	624	672	699	872	994	1,062
Tax	(11)	(16)	(26)	(27)	(34)	(39)	(41)
Net Profit (Reported)	551	608	646	672	838	955	1,021
Interest Payment on Tier-1 Perpetual Note	(55)	(55)	(55)	(55)	(55)	(60)	(66)
Social & Sports Contribution Fund	(14)	(15)	(16)	(17)	(21)	(24)	(26)
Net Profit (Attributable)	482	538	575	600	762	871	930

Source: Company financials, QNB FS Research

Balance Sheet (In QR mn)	2017	2018	2019	2020e	2021e	2022e	2023e
Cash & Balances with Central Bank	2,587	2,881	2,182	2,449	2,497	2,676	3,197
Interbank Loans	6,617	6,100	7,753	6,271	6,897	5,787	7,105
Net Investments	12,506	10,788	12,355	14,262	15,961	17,550	19,102
Net Loans	35,094	31,636	30,817	32,774	35,069	37,581	39,955
Other Assets	689	219	120	125	133	143	208
Net PP&E	235	335	408	454	505	522	540
Goodwill & Intangible Assets	156	143	133	101	97	97	97
Total Assets	57,885	52,102	53,768	56,435	61,159	64,357	70,205
Liabilities							
Interbank Deposits	10,597	9,563	11,080	12,418	15,246	15,481	18,674
Customer Deposits	32,683	28,845	29,191	29,863	31,206	33,453	35,527
Term Loans	5,743	5,608	5,647	5,896	5,976	6,025	5,887
Other Liabilities	1,570	1,510	846	926	905	970	1,030
AT1 Perpetual Bond	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Total Liabilities	51,593	46,526	47,765	50,102	54,333	56,930	62,119
Total Shareholders' Equity	6,292	5,577	6,003	6,333	6,826	7,427	8,087
Total Liabilities & Shareholders' Equity	57,885	52,102	53,768	56,435	61,159	64,357	70,205

Source: Company financials, QNB FS Research

Ratios/Financial Indicators	2017	2018	2019	2020e	2021e	2022e	2023e
Profitability (%)							
RoE Tangible (Based on Beg. Book Value)	8.2	8.8	10.6	10.2	12.2	13.0	12.7
RoAA (Attributable)	0.8	1.0	1.1	1.1	1.3	1.4	1.4
RoRWA (Attributable)	0.9	1.1	1.2	1.2	1.4	1.5	1.5
NIM (% of IEAs)	1.8	1.8	2.0	2.2	2.2	2.3	2.3
NIM (% of RWAs)	2.4	2.4	2.6	3.0	3.1	3.2	3.1
NIM (% of AAs)	1.7	1.7	1.9	2.0	2.1	2.2	2.2
Spread	1.4	1.5	1.6	1.9	1.9	2.0	2.0
Efficiency (%)							
Cost-to-Income (Headline)	27.6	28.8	27.9	25.8	23.6	22.6	22.5
Cost-to-Income (Core)	27.8	28.8	28.0	25.8	23.8	22.8	22.7
Liquidity (%)							
LDR	107.4	109.7	105.6	109.8	112.4	112.3	112.5
Loans/Assets	60.6	60.7	57.3	58.1	57.3	58.4	56.9
Cash & Interbank Loans-to-Total Assets	15.9	17.2	18.5	15.5	15.4	13.2	14.7
Deposits to Assets	56.5	55.4	54.3	52.9	51.0	52.0	50.6
Wholesale Funding to Loans	46.3	46.1	50.4	52.6	57.2	54.0	58.8
IEAs to IBLs	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Asset Quality (%)							
NPL Ratio	1.9	1.9	1.9	1.9	1.8	1.8	1.9
NPLs to Shareholders' Equity	11.1	11.0	10.1	10.1	9.9	9.6	9.7
NPLs to Tier-1 Capital	10.5	10.4	9.2	9.3	9.4	9.2	9.4
Coverage Ratio	118	228	251	264	272	278	273
ALL/Average Loans	2.3	4.1	4.6	5.0	5.1	5.2	5.2
Cost of Risk	84	60	59	61	54	50	51
Capitalization (%)							
CET1 Ratio	14.2	13.0	15.2	15.0	14.9	15.2	14.9
AT1 Ratio	2.5	2.7	2.7	2.6	2.4	2.3	2.0
Tier-1 Ratio	16.7	15.6	17.9	17.6	17.3	17.5	16.9
CAR	16.7	16.9	19.1	18.8	18.5	18.7	18.1
Leverage (x)	9.2	9.3	9.0	8.9	9.0	8.7	8.7
Growth (%)							
Net Interest Income	7.9	(7.0)	7.1	14.7	10.4	9.8	7.6
Non-Interest Income	(6.9)	(1.0)	(13.3)	(19.3)	18.9	10.8	(5.6)
Total Revenue	4.7	(5.9)	3.0	9.0	11.4	9.9	5.9
OPEX	(1.9)	(1.6)	(0.1)	0.4	2.1	5.4	5.4
Net Operating Income	7.5	(7.5)	4.2	12.3	14.7	11.3	6.0
Net Provisions & Impairments	(21.0)	(40.3)	(7.3)	32.7	(5.5)	0.8	2.0
Net Income (Reported)	29.1	10.5	6.2	4.0	24.8	14.0	6.9
Net Income (Attributable)	28.8	11.7	6.9	4.3	27.0	14.3	6.7
Loans	(0.2)	(9.9)	(2.6)	6.4	7.0	7.2	6.3
Deposits	1.5	(11.7)	1.2	2.3	4.5	7.2	6.2
Assets	(4.5)	(10.0)	3.2	5.0	8.4	5.2	9.1
RWAs	(3.1)	(5.5)	(2.3)	5.4	7.3	6.3	10.7

Source: Company financials, 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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