

Al Khalij Commercial Bank/Al Khaliji (KCBK)

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	QR22.25	Target Price	QR23.00
Implied Upside	3.4%		

Core Income Boosts Sequential Gains in 2Q2014 Earnings

Core banking income drives KCBK's net profit QoQ. Al Khaliji registered a net profit of QR149.6mn in 2Q2014, an increase of 37.0% QoQ and a drop of 5.9% YoY. 2Q2014 net income beat our estimates as well as consensus forecasts by a wide margin. Net income on a QoQ basis was driven by robust performance stemming from net interest income and fees & commissions.

Highlights

- 2Q2014 analysis:** Net interest income surged by 19.8% QoQ (+30.9% YoY) to reach QR198.6mn. Hence, annualized NIM climbed up to ~1.91% vs. ~1.70% in 1Q2014. Moreover, fees & commissions surprised on the upside, growing by 17.5% QoQ (+28.7% YoY) to rest at QR44.5mn. On the other hand, investment income exhibited muted performance. KCBK posted gains from investment securities of QR12.7mn vs. QR2.9mn in 1Q2014 (QR93.9mn in 2Q2013). As such, YoY growth in net profit was dented mainly due to small investment gains. OPEX was flat QoQ at QR104.8mn (+8.6% YoY). Thus, the core cost-to-income ratio improved to 42.8% vs. 51.0% in 1Q2014 (2Q2013: 51.4%). Finally, KCBK reported a net reversal of QR1.6mn in 2Q2014 vs. a reversal of QR4.8mn in 1Q2014 (2Q2013 provision of QR18.4mn).
- Healthy loan growth.** The bank's loan book gained by 3.4% QoQ (14.6% YTD), reaching QR23.7bn, while deposits expanded by 16.6% QoQ (26.9% YTD). Thus, KCBK's LDR dropped to 94% vs. 106% in 1Q2014 (FY2013: 104%). The NPL ratio further improved to 0.25% vs. 0.34% at the end of 2013.
- Outlook for 2014 & 2015:** We expect the bank's bottom-line to drop by 5.7% (to QR519.3mn) on the back of muted investment gains. On the other hand, we estimate net income to grow by 22.5% in 2015 to QR635.9mn as a result of healthy growth in core banking income and normalizing investment income. We also expect net loans to expand by 25.4% and 18.1% in 2014 and 2015, respectively.

Catalysts

- Visible progress in management's 3-year strategy:** 1) a consistent rise in market share; 2) an expansion of RoAE beyond 12% (FY2013 RoAE: 9.7%); 3) less reliance on treasury operations and 4) announcements/newsflow on infrastructure projects.

Recommendation, Valuation and Risks

- Recommendation and valuation:** We maintain KCBK a Market Perform with a price target of QR23.00. KCBK trades at a FY2014e P/B of 1.4x.
- Risks:** 1) KCBK's market share does not materialize; 2) Untested loan book and asset quality and 3) concentration risk.

Key Financial Data and Estimates

	2012	2013	2014e	2015e
EPS (QR)	1.42	1.53	1.44	1.77
EPS Growth	5.18	7.6	(5.7)	22.5
P/E (x)	15.6	14.5	15.4	12.6
BVS (QR)	15.75	15.66	16.28	17.00
P/B (x)	1.4	1.4	1.4	1.3
DPS (QR)	1.00	1.00	1.00	1.20
Dividend Yield (%)	4.5	4.5	4.5	5.4

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

Key Data

Current Market Price (QR)	22.25
Dividend Yield (%)	4.5
Bloomberg Ticker	KCBK QD
ADR/GDR Ticker	N/A
Reuters Ticker	KCBK.QA
ISIN	QA000A0M6MD5
Sector	Banks & Financial Services
52wk High/52wk Low (QR)	25.85/16.60
3-m Average Volume ('000)	223.3
Mkt. Cap. (\$ bn/QR bn)	2.2/8.0
Shares Outstanding (mn)	360.0
FO Limit* (%)	25.0
Current FO* (%)	13.5
1-Year Total Return (%)	39.1
Fiscal Year End	December 31

Source: Bloomberg (as of July 21, 2014), *Qatar Exchange (as of July 20, 2014); Note: FO is foreign ownership

Shahan Keushgerian

+974 4476 6509

shahan.keushgerian@qnbfs.com.qa

Saugata Sarkar

+974 4476 6534

saugata.sarkar@qnbfs.com.qa

Revising Estimates

We adjust some of our assumptions for 2014 and 2015 and change our price target accordingly. We maintain our net interest income for 2014. However, we slightly decrease this figure in 2015 since we assume moderate margin pressure. KCBK is aggressively tapping the corporate sector and expanding its loan book. As such, we assume the bank may forego higher margins in order to attract more business. The change in non-interest income is mainly attributed to investment gains. We have significantly lowered our investment gains estimates both for 2014 and 2015. There are two reasons for this: 1) the bank does not want to rely on investment gains for growth but desires core banking income to drive growth; and 2) based on KCBK's 1H2014 financials, there is limited room for investment gains as per the change in fair value of AFS investment under other comprehensive income. **Based on our revised estimates, our new price target for KCBK is QR23.00 vs. QR23.30 previously.**

Major Estimate Changes

	2014e			2015e		
	Old	New	Change (%)	Old	New	Change (%)
Net Interest Income	734	729	-0.7	866	843	-2.7
Non Interest Income	299	220	-26.5	305	265	-13.2
Operating Income	624	523	-16.3	742	683	-7.9
Net Income	590	519	-12.0	694	636	-8.4

Source: Company data, QNBFS estimates

Detailed Financial Statements

Income Statement (In QR mn)	2012	2013	2014e	2015e
Net Interest Income	511	590	722	843
Fees & Commissions	73	143	164	181
FX Income	(12)	26	20	21
Dividend Income	6	7	6	6
Gains from Investment Securities	390	174	30	56
Other Income	1	1	(0)	1
Non-Interest Income	458	352	220	265
Total Income	969	942	941	1,107
Operating Expenses	(373)	(383)	(419)	(424)
Net Provisions & Investment Impairment	(67)	9	13	(27)
Net Profit Before Taxes & Non-Recurring Items	529	568	536	656
Non-Recurring Income/(Loss)	-	-	-	-
Net Profit Before Taxes	529	568	536	656
Tax	(17)	(17)	(17)	(20)
Net Profit	512	551	519	636

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

Balance Sheet (In QR mn)	2012	2013	2014e	2015e
Assets				
Cash & Balances with Central Bank	1,779	1,297	1,613	1,888
Interbank Loans	2,241	4,286	2,958	4,090
Net Investments	15,865	13,898	17,452	20,044
Net Loans	13,032	20,697	25,946	30,637
Other Assets	416	725	856	1,011
Net PP&E	67	85	95	106
Goodwill & Intangible Assets	274	270	270	270
Total Assets	33,672	41,259	49,191	58,046
Liabilities				
Interbank Deposits	10,031	12,888	13,306	17,124
Customer Deposits	17,346	19,919	26,891	31,463
Term Loans	120	1,899	1,922	1,922
Other Liabilities	505	915	1,210	1,416
Total Liabilities	28,001	35,622	43,330	51,925
Shareholder's Equity				
Share Capital	3,600	3,600	3,600	3,600
Statutory Reserves	1,067	1,122	1,122	1,122
Risk Reserves	258	431	523	617
Fair Value Reserve	233	5	86	86
Foreign Currency Translation Reserve	14	30	27	27
Proposed Dividends	360	360	360	432
Retained Earnings	139	88	142	236
Total Shareholder's Equity	5,671	5,637	5,861	6,121
Total Liabilities & Shareholder's Equity	33,672	41,259	49,191	58,046

Source: Company data, QNBFS estimates

Key Ratios

	2012	2013	2014e	2015e
Profitability (%)				
NIM	1.8	1.7	1.7	1.7
Spread	1.6	1.8	1.6	1.6
RoAE	9.3	9.7	9.0	10.6
RoAA	1.7	1.5	1.1	1.2
RoRWA	2.3	2.1	1.7	1.9
Efficiency (%)				
Cost-to-Income (Headline)	38.5	40.6	44.5	38.3
Cost-to-Income (Core)	64.5	49.8	46.0	40.4
Liquidity (%)				
LDR	75.1	103.9	96.5	97.4
Loans/Assets	38.7	50.2	52.7	52.8
Liquid Assets-to-Total Assets	53.9	43.5	40.9	41.1
Asset Quality (%)				
NPL Ratio	0.45	0.34	0.25	0.28
NPLs-to-Shareholder's Equity	1.04	1.25	1.12	1.41
Cost of Risk	0.5	-0.1	-0.1	0.1
Capitalization (%)				
Tier 1 Ratio	19.4	16.7	16.6	14.8
CAR	21.4	18.4	18.2	16.3
Growth (%)				
Net Interest Income	(13.0)	15.5	22.2	16.8
Net Operating Income	9.3	-2.7	-0.1	17.6
Net Income	5.2	7.6	-5.7	22.5
Loans	13.2	58.8	25.4	18.1
Deposits	43.0	14.8	35.0	17.0

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

Contacts

Saugata Sarkar

Head of Research

Tel: (+974) 4476 6534

saugata.sarkar@qnbfs.com.qa

Abdullah Amin, CFA

Senior Research Analyst

Tel: (+974) 4476 6569

abdullah.amin@qnbfs.com.qa

Shahan Keushgerian

Senior Research Analyst

Tel: (+974) 4476 6509

shahan.keushgerian@qnbfs.com.qa

Sahbi Kasraoui

Manager – HNWI

Tel: (+974) 4476 6544

sahbi.alkasraoui@qnbfs.com.qa

Ahmed Al-Khoudary

Head of Sales Trading – Institutional

Tel: (+974) 4476 6548

ahmed.alkhoudary@qnbfs.com.qa

QNB Financial Services SPC

Contact Center: (+974) 4476 6666

PO Box 24025

Doha, Qatar

DISCLAIMER: This publication has been prepared by QNB Financial Services SPC ("QNBFS") a wholly-owned subsidiary of Qatar National Bank ("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. 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. While this publication has been prepared with the utmost degree of care by our analysts, 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. 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.

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