

Al Khalij Commercial Bank (KCBK)

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	QR11.19	Target Price	QR15.00
Implied Upside	+34.0%		

3Q2018 Falls Short of Estimates

Al Khalij Commercial Bank is one of the smallest banks domestically. In terms of loans (~4% market share as of 2017), 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 (8.0% 2017) among listed banks and it is below its cost of equity of 12.10%. Based on average RoE of 10.83% within our forecast horizon vs. cost of equity of 12.10%, the bank is generating economic losses. It should be noted that the reason for low returns is due to the fact that bank's liquid assets to total assets is on the high side at 35% along with a fixed income portfolio that is 21% of assets (mostly invested in low yielding sovereign bonds)

Highlights

- KCBK's 3Q2018 net income flat YoY is attributed to 51.1% drop in provisions & impairments; QoQ decline in profitability was a result of weak revenue and higher net provisions & impairments.** KCBK reported net income of QR134.1mn (falling short of our estimate QR162.0mn due to weaker than expected revenue), flat YoY (-19.2% QoQ).
- Opex containment persisted but drop in revenue YoY and sequentially lifted C/I ratio.** Revenue declined by 16.3% YoY (-10.6% QoQ) while opex receded by 3.9% YoY (declined by 5.5% QoQ). As a result, KCBK generated negative JAWS. Moreover, C/I ratio moved up to 29.9% in 3Q2018 vs. 28.2% in 2Q2018 (26.0% in 3Q2017). On a 9 months basis the efficiency ratio (27.8%) is acceptable and still in-line within management's target.
- Margins contracted sequentially and on a YoY basis.** Net interest income decreased by 13.9% YoY (-6.2% QoQ) to QR219.2mn. Hence, NIM contracted by 12bps YoY and 10bps QoQ to -1.75%. CoFs expanded by 46bps YoY (+37bps QoQ) to 2.84%, outpacing Yields. Yield on assets moved up by 38bps YoY (+19bps QoQ) to 4.23%, leading the pressure on margins.
- Gross loans and deposits continued to decline.** Gross loans declined 4.4% QoQ (-4.0% YTD) to QR34.5bn while deposits receded by 5.1% QoQ (down 3.3% YTD) to QR31.6bn. As such, LDR remained flat sequentially at 104% vs. 107% in at the end of 2017. Including long-term funding (excluding inter-bank deposits), LDR works out to 90%. *The bank continues on divesting non-core loans.*
- NPLs remained stable, CoR dropped.** The bank's NPLs remained stable on a YTD basis. As such, the NPL ratio also remained constant at 1.94% vs. 1.94% at the end of 2017. Moreover, the coverage ratio (coverage of stage 3 loans/NPLs) remained healthy at 79%. We expect the coverage ratio to continuously increase as management exercises prudent risk control. CoR (9 months annualized) improved, declining to 77bps vs. 84bps in 2017. Under IFRS 9, stage 1 loans represent 84% of total loans while stage 2 loans are 14%.
- Capital position remains strong.** KCBK ended 3Q2018 with a CET1 ratio of 13.2% and Tier-1 ratio of 17.2% (including AT1 capital).

Catalysts

- Visible progress in management's strategy:** 1) an expansion of attributable RoE beyond 12% (2018e and 2019e RoE: 8.4% and 10.5%, respectively) & 2) improvement in the liquidity of the stock.

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 7.3x on our 2018 estimates, respectively.
- Risks:** 1) Geopolitical Factors/issues, 2) KCBK's market share gains do not materialize; 3) possible asset quality concerns and 4) concentration risk.

Key Financial Data and Estimates

	FY2017	FY2018e	FY2019e	FY2020e
EPS (QR)	1.38	1.54	1.74	1.89
EPS Growth (%)	28.8	11.8	13.3	8.3
P/E (x)	8.2	7.3	6.4	5.9
Tangible BVPS (QR)	17.0	15.2	16.2	17.3
P/TB (x)	0.7	0.7	0.7	0.6
DPS (QR)	0.75	0.75	0.75	1.00
Dividend Yield (%)	6.6	6.7	6.7	8.9

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

Key Data

Current Market Price (QR)	11.19
Dividend Yield (%)	6.7
Bloomberg Ticker	KCBK QD
ADR/GDR Ticker	N/A
Reuters Ticker	KCBK.QA
ISIN	QA000A0M6MD5
Sector*	Banks & Fin. Svcs.
52wk High/52wk Low (QR)	14.50/10.70
3-m Average Volume ('000)	53.8
Mkt. Cap. (\$ bn/QR bn)	1.1/4.0
Shares Outstanding (mn)	360.0
FO Limit* (%)	49.0
Current FO* (%)	10.9
1-Year Total Return (%)	-2.0
Fiscal Year End	December 31

Source: Bloomberg (as of October 24, 2018), *Qatar Exchange (as of October 24, 2018); Note: FO is foreign ownership

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Detailed Financial Statements

Income Statement (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Net Interest Income	984	924	977	1,063
Fees & Commissions	182	190	205	186
FX Income	39	49	48	54
Other Income	9	(9)	14	16
Non-Interest Income	231	230	266	256
Total Revenue	1,215	1,154	1,244	1,319
Operating Expenses	(335)	(330)	(340)	(351)
Net Operating Income	880	823	904	967
Net Provisions & Impairments	(319)	(202)	(206)	(218)
Net Profit Before Taxes & Non-Recurring Items	562	621	698	749
Non-Recurring Income	-	-	-	-
Net Profit Before Tax	562	621	698	749
Tax	(11)	(12)	(27)	(28)
Net Profit (Headline/Reported)	551	609	671	721
Interest Payment on AT1 Note	(55)	(55)	(55)	(55)
Social & Sports Contribution Fund	(14)	(15)	(17)	(18)
Net Profit (Attributable)	482	539	600	648

Source: Company financials, QNBFS Research

Balance Sheet (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Assets				
Cash & Balances with Central Bank	2,587	2,500	2,544	2,442
Interbank Loans	6,617	5,334	6,904	5,291
Net Investments	12,506	13,258	14,327	12,880
Net Loans	35,094	34,485	36,730	40,442
Other Assets	689	759	551	566
Net PP&E	235	251	263	273
Goodwill & Other Intangibles	156	148	140	125
Total Assets	57,885	56,734	61,457	62,019
Liabilities				
Interbank Deposits	10,597	10,360	12,646	8,294
Customer Deposits	32,683	33,336	36,337	40,697
Term Loans & Borrowings	5,743	4,744	4,065	4,065
Other Liabilities	1,570	1,667	1,453	1,628
AT1 Perpetual Bonds	1,000	1,000	1,000	1,000
Total Liabilities	51,593	51,107	55,501	55,684
Total Shareholders' Equity	6,292	5,627	5,956	6,334
Total Liabilities & Shareholders' Equity	57,885	56,734	61,457	62,019

Source: Company financials, QNBFS Research

Ratios/Financial Indicators	FY2017	FY2018e	FY2019e	FY2020e
Profitability (%)				
RoAE (Attributable)	7.8	9.0	10.4	10.5
RoAA (Attributable)	0.8	0.9	1.0	1.0
RoRWA (Attributable)	0.9	1.1	1.1	1.2
NIM (% of IEAs)	1.8	1.7	1.8	1.8
NIM (% of RWAs)	2.4	2.4	2.4	2.5
NIM (% of AAs)	1.7	1.6	1.7	1.7
Spread	1.7	1.5	1.5	1.5
Efficiency (%)				
Cost-to-Income (Headline)	27.6	28.6	27.3	26.6
Cost-to-Income (Core)	27.8	28.4	27.6	27.0
Liquidity (%)				
LDR	107	103	101	99
Loans/Assets	60.6	60.8	59.8	65.2
Cash & Interbank Loans-to-Total Assets	15.9	13.8	15.4	12.5
Deposits to Assets	56.5	58.8	59.1	65.6
Wholesale Funding to Loans	46.3	41.8	45.5	30.6
IEAs to IBLs	117.6	118.8	114.9	117.1
Asset Quality (%)				
NPL Ratio	1.94	1.92	1.65	1.55
NPL to Shareholders' Equity	11.10	12.38	10.70	10.40
NPLs to Tier-1 Capital	10.49	11.22	9.74	9.62
Coverage Ratio	118	136	167	184
ALL/Average Loans	2.3	5.0	5.1	5.1
Cost of Risk	84	50	50	52
Capitalization (%)				
Tier-1 Ratio	16.7	16.2	15.7	15.3
CAR	16.7	16.2	15.7	15.3
Tier-1 Capital to Assets	11.5	10.9	10.7	11.0
Tier-1 Capital to Loans	19.0	18.0	17.8	16.9
Tier-1 Capital to Deposits	20.4	18.6	18.0	16.8
Leverage (x)	9.2	10.1	10.3	9.8
Growth (%)				
Net Interest Income	7.9	-6.1	5.8	8.7
Non-Interest Income	-6.9	-0.4	15.9	-3.9
OPEX	-1.9	-1.3	2.8	3.4
Net Operating Income	7.5	-6.5	9.8	7.0
Net Income (Reported/Headline)	29.1	10.6	10.2	7.4
Loans	-0.2	-1.7	6.5	10.1
Deposits	1.5	2.0	9.0	12.0
Assets	-4.5	-2.0	8.3	0.9
RWAs	-3.1	-4.1	8.9	7.2

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

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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