

National Bank of Kuwait (NBK)

Recommendation	ACCUMULATE	Risk Rating	R-3
Share Price	KWd 913	Target Price	KWD 1.053
Implied Upside	+15.3%	Old Target Price	KWd 856

Encouraging 2018; Increasing PT to KWD 1.053

We increase our estimates and forecast double-digit growth in profitability over the next few years; we raise our PT to KWD 1.053 vs. KWd 856 (previously). We maintain our Accumulate rating. The stock has rallied over the past year on the back of FTSE EM inclusion in 2H2018, weight increase in MSCI FM, watch list for possible MSCI EM inclusion and removal of FOL. NBK trades at 10% and 22% discounts to its historical P/B and P/E. Moreover, the market is pricing in a sustainable tangible RoE of 16.5% vs. 17.4% based on our estimates (16.2% previously).

Highlights

- NBK's 2018 attributable bottom-line increased by 15.8% on the back of international operations and retail banking.** NBK reported a net profit of KWD 355.5mn vs. KWD 307.1mn in 2017. Total revenue grew by 8.2%, driven by net interest income, fees and f/x income while opex grew by only 4.1%. Hence, net operating income moved up by 10.1% to KWD 613.0mn.
- Cash DPS grew by 22.8%.** NBK recommended a cash DPS of KWd 35.00 vs. KWd 30.00 in 2017 (yielding 3.8% and payout of 60%) and stock dividend of 5.0%.
- Margins continued to expand in 2018.** Net interest income increased by 9.8% to KWD 690.4mn; NBK's net interest margin expanded by 8bps.
- Operating efficiency remains healthy with positive JAWS.** NBK's C/I ratio improved to 31.1% vs. 32.3% in 2017 (33.8% in 2016) driven by cost containment and growth in revenue. Hence, the bank generated JAWS of 4.1% (4.9% in 2017). We estimate the C/I ratio to improve further in 2019 (30.1%) and 2020 (28.8%).
- NBK still generates the highest RoE in Kuwait.** Tangible RoE increased to 14.5% in 2018 vs. 13.3% in 2017. We are of the view the bank could produce a tangible RoE of 16.4% in 2019, assuming a 3.6% drop in provisions and impairments. NBK is capable of producing RoE greater than 16% while maintaining a CAR of ~17%, which is very positive.
- CoR improved and we expect further progress.** NBK booked credit provisions of KWD 169.3mn vs. KWD 175.0mn in 2017, which translates into CoR of 109bps & 119bps, respectively. As of 2018, general provisions to total provisions amounted to 76% vs. 82% in 2017. We estimate CoR to recede to 98bps (2019), 94bps (2020) and 92bps (2021).
- Provisions greater than IFRS 9 requirements.** NBK has so far built up credit reserves of KWD 505.7mn vs. ECLs of KWD 408.1mn under IFRS 9 resulting in excess provisions of KWD 97.6mn. We await guidance from the Central Bank as to how the banks should proceed with provisioning going forward.
- Asset quality continued its positive trajectory.** NBK's asset quality improved with the bank's NPL ratio declining to 1.32% from 1.38% in 2017 (1.42% in 2016) partly driven by write-offs & reversals. Moreover, the coverage ratio decreased to 228% vs. 287% in 2017, which is not a negative as the coverage is already on the high side. We expect the NPL ratio to remain broadly stable going forward.
- Net loans increased driven by the retail segment.** Net loans grew by 6.9% YoY to KWD 15.5bn while deposits (excluding OFIs) gained by 4.0% to KWD 14.8bn. The growth in loans was mainly attributed to the retail segment which expanded by 8.1%. We pencil in 7.5% and 8.3% growth in loans for 2019 and 2020, respectively.
- Capitalization remains strong.** NBK generated CET1 ratio of 13.8% vs. 14.2% in 2017, while total CAR rested at 17.2%. We forecast NBK's capitalization at current levels.

Catalysts

- 1) Signs/hints of provision reversals, 2) Revival of bid for the remaining 42% stake in Boubyan Bank, 3) Beneficiary if Kuwait gets upgraded to MSCI EM status.

Recommendation, Valuation and Risks

- Recommendation and valuation:** NBK is trading at a 2019e P/B and P/E of 2.0x and 13.2x, respectively. We maintain our Accumulate rating.
- Risks:** 1) Geo-political factors & 2) CoR does not improve.

Key Financial Data and Estimates

	FY2018	FY2019e	FY2020e	FY2021e
EPS (KWd)	58.05	69.03	79.61	88.57
EPS Growth (%)	15.8	18.9	15.3	11.3
P/E (x)	15.7	13.2	11.5	10.3
Tangible BVPS (KWd)	422.0	451.4	491.6	535.6
P/TB (x)	2.2	2.0	1.9	1.7
DPS (KWd)	35.00	40.00	45.00	50.00
Dividend Yield (%)	3.8	4.4	4.9	5.5

Source: Company data, QNB FS Research

Key Data

Current Market Price (KWd)	913
Dividend Yield (%)	3.8
Bloomberg Ticker	NBK KK
ADR/GDR Ticker	N/A
Reuters Ticker	NBKK.KW
ISIN	KW0EQ0100010
Sector	Banks & Financial Svcs.
52wk High/52wk Low (KWd)	918/705
3-m Average Volume (mn)	5.2
Mkt. Cap. (\$ bn/KWD bn)	5.6/18.5
Shares Outstanding (mn)	6,124.1
1-Year Total Return (%)	28.1
Fiscal Year End	December 31

Source: Bloomberg (as of March 6, 2019)

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Change in Estimates

(In KWD mn)	2019e			2020e			2021e		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Net Interest Income	771	760	(1.4)	841	846	0.6	927	931	0.4
Non Interest Income	198	205	3.5	195	216	10.6	203	230	13.4
Total Revenue	969	965	(0.4)	1,036	1,061	2.4	1,130	1,161	2.8
OPEX	304	290	(4.5)	329	306	(7.0)	359	330	(8.0)
Net Operating Income	665	675	1.5	707	755	6.8	771	831	7.8
Net Provisions & Impairments	167	173	3.7	162	179	10.8	173	192	11.1
Net Profit Before Taxes, Minorities & Othe	498	502	0.7	545	576	5.6	598	639	6.8
Others	63	64	0.9	68	73	7.3	74	81	9.1
Net Income (Reported/Headline)	435	438	0.7	477	503	5.4	524	558	6.5
Net Income (Attributable)	419	423	0.9	461	488	5.8	508	542	6.8

Source: QNB FS Research

Detailed Financial Statements

Income Statement (In QR mn)	FY2018	FY2019e	FY2020e	FY2021e
Net Interest Income	690	760	846	931
Fees & Commissions	150	155	162	174
FX Income	39	41	45	47
Other Income	4	9	8	9
Non-Interest Income	193	205	216	230
Total Revenue	883	965	1,061	1,161
Operating Expenses	(276)	(290)	(306)	(330)
Net Operating Income	607	675	755	831
Net Provisions & Impairments	(180)	(173)	(179)	(192)
Net Profit Before Tax	427	502	576	639
Tax	(33)	(37)	(42)	(47)
Net Profit Before Minority Interest	394	465	534	592
Minority Interest	(23)	(27)	(31)	(34)
Net Profit (Headline/Reported)	371	438	503	558
Interest on Tier-1 Note	(15)	(15)	(15)	(15)
Net Profit (Attributable)	356	423	488	542

Source: Company data, QNB FS Research

Balance Sheet (In KWD mn)	FY2018	FY2019e	FY2020e	FY2021e
Assets				
Cash & Balances with Central Bank	2,967	3,073	3,526	3,879
Interbank Loans	2,364	2,667	2,708	2,747
Net Investments	5,360	5,700	6,547	6,971
Net Loans	15,503	16,671	18,051	19,622
Investment in Associates	31	32	33	34
Other Assets	222	217	235	255
Net PP&E	363	399	439	483
Investment Properties & OREO	39	39	39	39
Goodwill & Intangibles	579	576	573	570
Total Assets	27,428	29,374	32,150	34,600
Liabilities				
Interbank Deposits	8,090	8,455	9,448	9,798
Customer Deposits	14,840	16,176	17,631	19,394
Global MTNs & Subordinated Tier-2 Notes	345	345	345	345
Other Liabilities	451	493	547	582
Tier-1 Perpetual Notes	211	211	211	211
Total Liabilities	23,937	25,679	28,182	30,330
Shareholders' Equity	3,163	3,341	3,583	3,850
Total Liabilities & Shareholders' Equity	27,428	29,374	32,150	34,600

Source: Company data, QNB FS Research

Ratios	FY2018	FY2019e	FY2020e	FY2021e
Profitability (%)				
RoE (Tangible)	14.5	16.4	17.6	18.0
RoAA	1.4	1.5	1.6	1.7
RoRWA	2.1	2.3	2.4	2.4
NIM (% of IEAs)	2.81	2.90	2.97	3.01
NIM (% of RWAs)	4.00	4.07	4.13	4.13
NIM (% of AAs)	2.58	2.68	2.75	2.79
Efficiency (%)				
Cost-to-Income (Headline)	31.1	30.1	28.8	28.5
Cost-to-Income (Core)	31.4	30.3	29.0	28.6
Liquidity (%)				
LDR (excluding OFIs)	104.5	103.1	102.4	101.2
Loans/Assets	56.5	56.8	56.1	56.7
Cash & Interbank Loans-to-Total Assets	19.4	19.5	19.4	19.2
Deposits to Assets	54.1	55.1	54.8	56.1
Wholesale Funding to Loans	54.4	52.8	54.3	51.7
IEAs to IBLs	1.4x	1.4x	1.4x	1.4x
Asset Quality (%)				
NPL Ratio	1.38	1.32	1.35	1.38
NPLs to Shareholders' Equity	7.0	6.8	7.1	7.3
NPLs to Tier 1 Capital	8.9	8.5	8.6	8.8
Coverage Ratio	228.1	271.2	279.7	279.9
ALL/Average Loans	0.8	1.4	1.7	1.9
Cost of Risk	109	98	94	92
Capitalization (%)				
Tier 1 Ratio	15.3	15.2	14.8	14.7
CAR	17.2	17.2	16.8	16.7
Tier 1 Capital to Assets	10.0	10.0	9.9	10.0
Tier 1 Capital to Loans	17.7	17.7	17.7	17.6
Tier 1 Capital to Deposits	18.4	18.2	18.1	17.8
Leverage (x)	8.7	8.8	9.0	9.0
Growth (%)				
Net Interest Income	9.8	10.1	11.3	10.1
Non-Interest income	3.0	3.0	5.2	6.8
Total Revenue	8.2	8.5	10.0	9.4
Opex	4.1	5.1	5.4	7.9
Net Operating Income	10.1	10.1	11.9	10.0
Net Provisions & Impairments	15.0	18.1	14.8	10.9
Net Income	15.8	18.9	15.3	11.3
Loans	6.9	7.5	8.3	8.7
Deposits	4.0	9.0	9.0	10.0
Assets	5.4	7.1	9.5	7.6
RWAs	8.1	8.1	11.1	9.2

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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