

## Al Khalij Commercial Bank (KCBK)

|                       |                       |                     |               |
|-----------------------|-----------------------|---------------------|---------------|
| <b>Recommendation</b> | <b>MARKET PERFORM</b> | <b>Risk Rating</b>  | <b>R-3</b>    |
| <b>Share Price</b>    | <b>QR1.24</b>         | <b>Target Price</b> | <b>QR1.40</b> |
| <b>Implied Upside</b> | <b>14.8%</b>          |                     |               |

### 3Q2019 Earnings Misses Estimates; YoY Earnings Driven by Strong Margins

*KCBK posted 3Q2019 net income of QR145.2mn, falling short of our estimate of QR163.1mn. The bottom-line was up 8.3% YoY due to strong margin expansion. Total revenue grew by 12.8%, driven by net interest income (+19.4% YoY) as non-funded income exhibited weak performance (fx and fee income). NIM improvement was visible along with cost containment. Liquidity remained strong with LDR at 93%. Cost of Risk (annualized) increased to 57bps vs. 46bps (9M2018), however we predict improvement in 4Q2019 and beyond. We retain our Market Perform rating and our price target to QR1.40. We revise our estimates for 2019, 2020 & 2021; the changes are insignificant (page 2).*

### Highlights

- KCBK's 3Q2019 net income increased by 8.3% YoY on the back of margin expansion despite higher opex and provisions.** KCBK reported net income of QR145.2mn, falling short of our estimate of QR163.1mn (-11.0% variation). The miss was mainly attributable to larger provisions vs. our estimate. Net operating income was broadly in-line with our estimate (+4.4% variation). The bank's revenue grew by 12.8%, driven by net interest income (+19.4% YoY) as non-funded income remained weak. The bottom-line sequentially declined by 17.4% as a result of weak fee income and a surge in provisions & impairments. *We are of the view that growth in 2019's bottom-line would be driven by an improvement in CoR and to an extent from net operating income (net interest income and cost efficiency).*
- Opex containment persisted and an uptick in 9M2019 revenue led to a flat C/I ratio.** 9M2019 revenue inched up by 1.1%, while opex remained flat. As a result, KCBK remained JAWS neutral in 9M2019. Moreover, C/I ratio remained at 27.5% vs. 27.8% in 9M2018. We do note the current efficiency ratio is acceptable and still in-line with management's target of less than 30%.
- Margins further improved due to yield on interest earning assets.** NIMs moved up by 27bps YoY and 25bps sequentially to 2.0%.
- Net loans & deposits finally picked up; loans were on the decline in the previous quarters as management shed non-core low yielding assets, targeting more lucrative deals.** Net loans expanded by 3.2% QoQ to QR30.0bn (-5.1% YTD) while deposits increased by 6.5% QoQ (-5.2% YTD) to QR27.3bn. The sequential growth in loans was mainly attributed to the public & retail segments. Nevertheless, KCBK's liquidity position remained strong with LDR (based on stable sources of funds) amounting to 93%.
- Asset quality remains a non-issue for now.** The bank's NPLs jumped by 8.0% QoQ (flat YTD). As such, the NPL ratio moved up to 1.93% vs. 1.84% in 2Q2019 (1.85% in FY2018). On the other hand, the coverage ratio (coverage of stage 3 loans/NPLs) remained flat at 83% vs. FY2018. We expect the coverage ratio to be adequately maintained as management exercises prudent risk control. 9M2019 CoR (annualized) increased to 57bps vs. 46bps (9M2018). *We expect lower provisions in the 4<sup>th</sup> quarter, leading to a CoR of 53bps in FY2019.*
- Tier-1 remained robust as the bank continued on optimizing RWAs.** The bank's CET1 and Tier-1 ratios remained sequentially flat at 14.9% (13.0% in 2018) and 17.8% (15.6% in 2018), respectively. Moreover, KCBK ended 3Q2019 with a CAR of 18.9% (16.9% in 2018). We expect capitalization to remain robust in 2019 and the coming years.

### Catalysts

- Visible progress in management's strategy:** 1) an expansion of attributable RoE beyond 12% (2019e and 2020e RoE: 10.3% and 11.2%, respectively), 2) improvement in the liquidity of the stock and 3) M&A activity.

### Recommendation, Valuation and Risks

- Recommendation and valuation: We maintain our Market Perform rating and target price at QR1.40.** KCBK trades at P/TB and P/E of 0.7x and 6.5x on our 2020 estimates, respectively. We continue to think the name is in search of a catalyst to move the stock upward.
- 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

|                    | 2018  | 2019e | 2020e | 2021e |
|--------------------|-------|-------|-------|-------|
| EPS (QR)           | 0.15  | 0.16  | 0.19  | 0.21  |
| Growth (%)         | 11.7  | 6.8   | 13.7  | 14.0  |
| P/E (x)            | 7.9   | 7.4   | 6.5   | 5.7   |
| TBVPS (QR)         | 1.51  | 1.59  | 1.70  | 1.83  |
| P/TB (x)           | 0.8   | 0.8   | 0.7   | 0.7   |
| DPS (QR)           | 0.075 | 0.075 | 0.075 | 0.095 |
| Dividend Yield (%) | 6.1   | 6.1   | 6.1   | 7.8   |

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

### Key Data

|                           |                    |
|---------------------------|--------------------|
| Current Market Price (QR) | 1.22               |
| Dividend Yield (%)        | 6.1                |
| Bloomberg Ticker          | KCBK QD            |
| ADR/GDR Ticker            | N/A                |
| Reuters Ticker            | KCBK.QA            |
| ISIN                      | QA000A0M6MD5       |
| Sector*                   | Banks & Fin. Svcs. |
| 52wk High/52wk Low (QR)   | 1.29/1.055         |
| 3-m Average Volume (mn)   | 0.76               |
| Mkt. Cap. (\$ bn/QR bn)   | 1.2/4.4            |
| Shares Outstanding (bn)   | 3.60               |
| FO Limit* (%)             | 49.0               |
| Current FO* (%)           | 10.5               |
| 1-Year Total Return (%)   | 15.9               |
| Fiscal Year End           | December 31        |

Source: Bloomberg (as of October 17, 2019), \*Qatar Exchange (as of October 17, 2019); Note: FO is foreign ownership

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## Change In Estimates

| In QR mn                       | 2019e |       |            | 2020e |       |            | 2021e |       |            |
|--------------------------------|-------|-------|------------|-------|-------|------------|-------|-------|------------|
|                                | Old   | New   | Change (%) | Old   | New   | Change (%) | Old   | New   | Change (%) |
| Net Interest Income            | 943   | 967   | 2.6%       | 1,026 | 1,051 | 2.4%       | 1,129 | 1,153 | 2.1%       |
| Non Interest Income            | 222   | 200   | -9.9%      | 224   | 214   | -4.2%      | 223   | 215   | -3.6%      |
| Total Revenue                  | 1,165 | 1,167 | 0.2%       | 1,250 | 1,265 | 1.2%       | 1,352 | 1,368 | 1.2%       |
| Opex                           | 330   | 330   | 0.0%       | 328   | 335   | 2.2%       | 340   | 346   | 1.7%       |
| Net Operating Income           | 835   | 837   | 0.3%       | 922   | 930   | 0.9%       | 1,012 | 1,022 | 1.0%       |
| Net Income (Reported/Headline) | 669   | 646   | -3.5%      | 724   | 727   | 0.4%       | 808   | 821   | 1.6%       |
| Net Income (Attributable)      | 598   | 575   | -3.8%      | 651   | 654   | 0.5%       | 733   | 746   | 1.7%       |

Source: QNB FS Research

## Detailed Financial Statements

| Income Statement (In QR mn)                   | 2016         | 2017         | 2018         | 2019e        | 2020e        | 2021e        |
|---|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>Net Interest Income</b>                    | <b>913</b>   | <b>984</b>   | <b>915</b>   | <b>967</b>   | <b>1,051</b> | <b>1,153</b> |
| Fees & Commissions                            | 198          | 182          | 190          | 176          | 184          | 194          |
| FX Income                                     | 31           | 39           | 38           | 21           | 28           | 26           |
| Other Income                                  | 19           | 9            | 0            | 2            | 3            | -5           |
| <b>Non-Interest Income</b>                    | <b>248</b>   | <b>231</b>   | <b>228</b>   | <b>200</b>   | <b>214</b>   | <b>215</b>   |
| <b>Total Revenue</b>                          | <b>1,160</b> | <b>1,215</b> | <b>1,143</b> | <b>1,167</b> | <b>1,265</b> | <b>1,368</b> |
| Operating Expenses                            | -341         | -335         | -329         | -330         | -335         | -346         |
| <b>Net Operating Income</b>                   | <b>819</b>   | <b>880</b>   | <b>814</b>   | <b>837</b>   | <b>930</b>   | <b>1,022</b> |
| Net Provisions & Investment Impairments       | -403         | -319         | -190         | -169         | -178         | -173         |
| Net Profit Before Taxes & Non-Recurring Items | 416          | 562          | 624          | 668          | 752          | 849          |
| Non-Recurring Income/(Loss)                   | 0            | 0            | 0            | 0            | 0            | 0            |
| <b>Net Profit Before Taxes</b>                | <b>416</b>   | <b>562</b>   | <b>624</b>   | <b>668</b>   | <b>752</b>   | <b>849</b>   |
| Tax   | 11           | -11          | -16          | -22          | -25          | -28          |
| <b>Net Profit (Headline/Reported)</b>         | <b>427</b>   | <b>551</b>   | <b>608</b>   | <b>646</b>   | <b>727</b>   | <b>821</b>   |
| Interest Payment on Tier-1 Perpetual Note     | -42          | -55          | -55          | -55          | -55          | -55          |
| Social & Sports Contribution Fund             | -11          | -14          | -15          | -16          | -18          | -21          |
| <b>Net Profit (Attributable)</b>              | <b>374</b>   | <b>482</b>   | <b>538</b>   | <b>575</b>   | <b>654</b>   | <b>746</b>   |

Source: Company financials, QNB FS Research

| Balance Sheet (In QR mn)                            | 2016          | 2017          | 2018          | 2019e         | 2020e         | 2021e         |
|---|---------------|---------------|---------------|---------------|---------------|---------------|
| Cash & Balances with Central Bank                   | 2,359         | 2,587         | 2,881         | 2,213         | 2,987         | 2,957         |
| Interbank Loans                                     | 6,489         | 6,617         | 6,100         | 6,112         | 6,273         | 5,914         |
| Net Investments                                     | 15,608        | 12,506        | 10,788        | 12,427        | 12,637        | 12,023        |
| Net Loans   | 35,180        | 35,094        | 31,636        | 30,579        | 33,188        | 36,720        |
| Other Assets  | 620           | 689           | 219           | 92            | 100           | 110           |
| Net PP&E  | 191           | 235           | 335           | 427           | 446           | 467           |
| Goodwill & Intangible Assets                        | 150           | 156           | 143           | 133           | 124           | 119           |
| <b>Total Assets</b>                                 | <b>60,597</b> | <b>57,885</b> | <b>52,102</b> | <b>51,982</b> | <b>55,754</b> | <b>58,311</b> |
| Liabilities   |               |               |               |               |               |               |
| Interbank Deposits                                  | 12,899        | 10,597        | 9,563         | 11,607        | 12,719        | 11,727        |
| Customer Deposits                                   | 32,195        | 32,683        | 28,845        | 27,657        | 29,870        | 32,857        |
| Term Loans  | 6,137         | 5,743         | 5,608         | 5,064         | 5,064         | 5,064         |
| Other Liabilities                                   | 2,333         | 1,570         | 1,510         | 802           | 866           | 953           |
| AT1 Perpetual Bond                                  | 1,000         | 1,000         | 1,000         | 1,000         | 1,000         | 1,000         |
| <b>Total Liabilities</b>                            | <b>54,564</b> | <b>51,593</b> | <b>46,526</b> | <b>46,131</b> | <b>49,520</b> | <b>51,601</b> |
| <b>Total Shareholders' Equity</b>                   | <b>6,033</b>  | <b>6,292</b>  | <b>5,577</b>  | <b>5,851</b>  | <b>6,234</b>  | <b>6,710</b>  |
| <b>Total Liabilities &amp; Shareholders' Equity</b> | <b>60,597</b> | <b>57,885</b> | <b>52,102</b> | <b>51,982</b> | <b>55,754</b> | <b>58,311</b> |

Source: Company financials, QNB FS Research

| <b>Ratios/Financial Indicators</b>          | <b>2016</b> | <b>2017</b> | <b>2018</b> | <b>2019e</b> | <b>2020e</b> | <b>2021e</b> |
|---|-------------|-------------|-------------|--------------|--------------|--------------|
| <b>Profitability (%)</b>                    |             |             |             |              |              |              |
| RoE Attributable (Based on Beg. Book Value) | 6.2         | 8.0         | 8.6         | 10.3         | 11.2         | 12.0         |
| RoAA (Attributable)                         | 0.6         | 0.8         | 1.0         | 1.1          | 1.2          | 1.3          |
| RoRWA (Attributable)                        | 0.7         | 0.9         | 1.1         | 1.2          | 1.3          | 1.4          |
| NIM (% of IEAs)                             | 1.7         | 1.8         | 1.8         | 2.0          | 2.1          | 2.2          |
| NIM (% of RWAs)                             | 2.3         | 2.4         | 2.4         | 2.7          | 2.8          | 2.8          |
| NIM (% of AAs)                              | 1.6         | 1.7         | 1.7         | 1.9          | 2.0          | 2.0          |
| Spread                                      | 1.5         | 1.4         | 1.5         | 1.7          | 1.8          | 1.8          |
| <b>Efficiency (%)</b>                       |             |             |             |              |              |              |
| Cost-to-Income (Headline)                   | 29.4        | 27.6        | 28.8        | 28.3         | 26.5         | 25.3         |
| Cost-to-Income (Core)                       | 29.9        | 27.8        | 28.8        | 28.3         | 26.6         | 25.2         |
| <b>Liquidity (%)</b>                        |             |             |             |              |              |              |
| LDR   | 109.3       | 107.4       | 109.7       | 110.6        | 111.1        | 111.8        |
| Loans/Assets                                | 58.1        | 60.6        | 60.7        | 58.8         | 59.5         | 63.0         |
| Cash & Interbank Loans-to-Total Assets      | 14.6        | 15.9        | 17.2        | 16.0         | 16.6         | 15.2         |
| Deposits to Assets                          | 53.1        | 56.5        | 55.4        | 53.2         | 53.6         | 56.3         |
| Wholesale Funding to Loans                  | 51.7        | 46.3        | 46.1        | 52.0         | 51.2         | 43.6         |
| IEAs to IBLs                                | 123.1       | 117.6       | 120.8       | 118.0        | 116.4        | 117.6        |
| <b>Asset Quality (%)</b>                    |             |             |             |              |              |              |
| NPL Ratio                                   | 1.5         | 1.9         | 1.9         | 1.9          | 1.8          | 1.5          |
| NPL to Shareholder's Equity                 | 9.0         | 11.1        | 11.0        | 10.7         | 9.8          | 8.6          |
| NPLs to Tier-1 Capital                      | 8.4         | 10.5        | 10.4        | 10.3         | 9.6          | 8.6          |
| Coverage Ratio                              | 110         | 118         | 228         | 242          | 267          | 303          |
| ALL/Average Loans                           | 1.7         | 2.3         | 4.1         | 4.6          | 4.9          | 4.8          |
| Cost of Risk                                | 103         | 84          | 60          | 53           | 50           | 45           |
| <b>Capitalization (%)</b>                   |             |             |             |              |              |              |
| Tier-1 Ratio                                | 15.8        | 16.7        | 15.6        | 17.3         | 16.2         | 15.3         |
| CAR   | 15.8        | 16.7        | 16.9        | 18.5         | 16.2         | 15.3         |
| Tier-1 Capital to Assets                    | 10.7        | 11.5        | 11.3        | 11.7         | 11.3         | 11.5         |
| Tier-1 Capital to Loans                     | 18.5        | 19.0        | 18.6        | 19.8         | 19.1         | 18.2         |
| Tier-1 Capital to Deposits                  | 20.2        | 20.4        | 20.4        | 21.9         | 21.2         | 20.3         |
| Leverage (x)                                | 10.0        | 9.2         | 9.3         | 8.9          | 8.9          | 8.7          |
| <b>Growth (%)</b>                           |             |             |             |              |              |              |
| Net Interest Income                         | (1.2)       | 7.9         | (7.0)       | 5.7          | 8.6          | 9.8          |
| Non-Interest Income                         | 12.7        | (6.9)       | (1.0)       | (12.4)       | 7.2          | 0.4          |
| OPEX  | (12.8)      | (1.9)       | (1.6)       | 0.2          | 1.6          | 3.1          |
| Net Operating Income                        | 8.8         | 7.5         | (7.5)       | 2.9          | 11.0         | 10.0         |
| Net Income (Reported/Headline)              | (31.8)      | 29.1        | 10.5        | 6.2          | 12.5         | 13.0         |
| Loans                                       | 5.2         | (0.2)       | (9.9)       | (3.3)        | 8.5          | 10.6         |
| Deposits                                    | 4.1         | 1.5         | (11.7)      | (4.1)        | 8.0          | 10.0         |
| Assets                                      | 7.0         | (4.5)       | (10.0)      | (0.2)        | 7.3          | 4.6          |
| RWAs  | 8.8         | (3.1)       | (5.5)       | (7.2)        | 11.8         | 11.4         |

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*

|                       |                      |
|-----------------------|----------------------|
| <b>OUTPERFORM</b>     | Greater than +20%    |
| <b>ACCUMULATE</b>     | Between +10% to +20% |
| <b>MARKET PERFORM</b> | Between -10% to +10% |
| <b>REDUCE</b>         | Between -10% to -20% |
| <b>UNDERPERFORM</b>   | Lower than -20%      |

### Risk Ratings

*Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*

|            |                                   |
|------------|-----------------------------------|
| <b>R-1</b> | Significantly lower than average  |
| <b>R-2</b> | Lower than average                |
| <b>R-3</b> | Medium / In-line with the average |
| <b>R-4</b> | Above average                     |
| <b>R-5</b> | Significantly above average       |

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